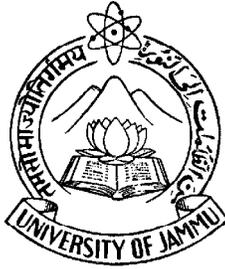


**Directorate of Distance Education**  
**UNIVERSITY OF JAMMU**  
**JAMMU**



**SELF LEARNING MATERIAL**  
**FOR**  
**B.COM SEMESTER - III**

**COURSE NO : BCG-302**

**UNIT : I-IV**

**SUBJECT : INCOME TAX**

**Lesson No. : 1 to 12**

*Course Coordinator :*  
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## **B.COM. THIRD SEMESTER**

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**UNIVERSITY OF JAMMU**  
**B.COM. THIRD SEMESTER**  
**INCOME TAX LAW AND PRACTICE - 1**

**C.No. BCG-302**

**Max Marks = 100**

**Internal assessment = 20**

**External Exam. = 80**

**(Syllabus for examination to be held in Dec. 2015, 2016, 2017 )**

**OBJECTIVE:** To impart knowledge about basic concepts pertaining to theory and practice of income tax

**UNIT I: BASIC TERMS**

Assessment year, previous year; Assessee: Deemed assessee, assessee in default, residential status, Person; Income: Capital receipts and revenue receipts, capital expenses vs. revenue expenses, capital losses vs. revenue losses, exempted incomes;.

**UNIT II: SALARY**

Taxability of provident fund- Public, statutory, superannuation and recognized and unrecognized provident fund; Allowances- Exempted, fully and partially taxable; Perquisites- Exempted, taxable in all cases, taxable in specified cases; Profits in lieu of salary; Computation of gross salary, deductions out of gross salary, computation of income from salary.

### **UNIT III: HOUSE PROPERTY**

**House Property-** Concept of annual rental value, MRV, FRV, ERV, standard rent, treatment of unrealized rent, vacancy, interest on loan- post & pre-construction period interest, deduction U/S24, computation of income from 'let out' and 'self-occupied house'.

### **UNIT IV: GAINS FROM BUSINESS AND PROFESSION**

Deductions allowed u/s 30 to 44A, expenses expressly disallowed, treatment of depreciation, computation of taxable business income, computation of professional income.

### **SKILL DEVELOPMENT (GUIDELINES FOR CLASS ROOM TEACHING AND INTERNAL ASSESSMENT)**

Enable the students to compute income under various heads.

Create deep understanding of all concepts specified in the syllabus.

### **BOOKS RECOMMENDED**

1. Income Tax Law & Accounts by Dr H C Meharotra and Dr S P Goyal : Sahitya Bhavan Publications.
2. Income tax Law and Practice by V.P.Gaur & D.B. Narang: Kalyani Publishers.
3. Direct taxes Law and Practices by V.K. Singhanian & Kapil Singhanian- Taxman publication.
4. Income tax Law and Practices by Mahesh Chandra, D.C. Shukla, K.A.Mahajan, M.A. Shah – Pragati publication, New Delhi.

5. Conceptual clarity on Income Tax & Wealth Tax by Arvind Tuli & Dr. Mrs. Neeru chadda – Kalyani Publication, New Delhi

**NOTE FOR PAPER SETTER**

Equal weightage shall be given to all the units of the syllabus. The external Paper shall be of the two sections viz, A & B of three hours duration.

**Section-A:** This section shall contain four short answer questions selecting one from each unit. Each question shall carry 5 marks .A candidate shall be required to attempt all the four questions. Total weightage to this section shall be of 20 marks.

**Section-B:** This section shall contain eight long answer questions of 15 marks each. Two questions with internal choice shall be set from each unit. A candidate shall have to attempt any four questions selecting one from each unit. Total weightage to this section shall be of 60 marks.

**MODEL QUESTION PAPER**  
**INCOME TAX LAW AND PRACTICE - I**

**Max Marks: -80**

**Time allowed: -3 hrs**

**Section A (20 Marks)**

**Attempt all the questions. Each question carries five marks.**

1. Define any two of the following
  - (a) Assessee
  - (b) Residential status
  - (c) Person
  - (d) Capital and revenue losses
2. Explain various types of allowances or perquisites.
3. Discuss briefly any two with suitable examples.
  - (a) Standard Rent
  - (b) MRV
  - (c) FRV
  - (d) ERV

4. Write a short note on expenses expressly allowed or disallowed in computation of business income.

**Section B (60 Marks)**

**Attempt any four questions selecting one question from each unit. Each question carries 15 marks.**

**UNIT - I**

1. Discuss revenue and capital incomes and expenses and also various systems of accounting with suitable examples.

OR

Discuss residential status of various 'Persons' with suitable examples.

**UNIT - II**

2. X' ltd. has advanced an interest free loan of Rs. 5,00,000 to R for purchase of car on 1-05-2008. R has been regularly repaying the loan in instalments of Rs. 20,000 p.m at the end of each month.
- a. Compute the value of perquisite on account of interest assuming the interest charged by SBI is 10% p.a.
- b. What shall be the valuation if the loan is being regularly repaid on the first of the next month instead of the end of the month.

OR

Discuss various deduction allowed u/s 80c.

**UNIT - III**

3. X' owns a house property. It is used by him throughout the previous year 2019-20 for his (and his family members) residence. Municipal value of the property is Rs. 1,66,000 whereas fair rent is Rs. 1,76,000 and standard rent

is Rs. 1,50,000. The following expenses are incurred by 'X' - repairs: Rs. 20,000, municipal taxes Rs. 16,000, insurance Rs. 2,000, interest on capital borrowed to construct the property Rs. 1,36,000, interest on capital borrowed on mortgaging the property for daughter's marriage, Rs. 20,000 (in either case capital is borrowed before April 1, 1999). Calculate income from house property of Mr. X for the previous year 2019-20.

OR

Calculate house property income of Mr. Z from the following information given below. Compute income from house property from the particulars given below for the assessment year 2019-21.

Municipal rental value	24,000 p.a
Actual rent received	30,000 p.a
Municipal taxes	2,400 p.a
Date of completion	31-3-2009
Date of letting	1-4-2009
Fire insurance premium (due)	400 p.a
Ground rent (due)	600 p/a
Interest on delayed payment of interest.	1000

#### UNIT - IV

4. Mr. A is a registered medical practitioner. He has prepared the following income and expenditure account for the previous year 2019-20. You are required to prepare his statement showing his income from professional.

**Income and expenditure account**

	<b>Rs.</b>		<b>Rs.</b>
Household Expenses	20,000	Consultation fees	10,000
Car purchased	30,000	Visiting fees	20,000
Travelling Expenses (Person)	4,000	Gains on Race (gross)	10,000
Charity & Donations	1,000	Share in sale proceeds of	
Income Tax	2,000	an ancestral house	34,000
Salaries	8,000	Profit on sale of securities	6,000
Gift to daughter	7,000	Dividend on shares (gross)	5,000
Establishment Exp.	1,000	Interest on P.O. Saving Bank	600
Surgical Equipment	4,000	Gift from Father – in – Law	2,000
Books	2,000	bad debts recovered (Not	
Life insurance premium	2,000	Allowed in earlier year)	2,000
Wealth – Tax	1,000	Interest on fixed deposit 1,300	
Interest on capital	1,000		
Surplus	<u>7,900</u>		<u>          </u>
	<u>90,900</u>		<u>90,900</u>

Rate of depreciation allowable on car is 15% and surgical equipment is at 15%. In case of books for profession the rate of depreciation is 60%.

OR

Following is the profit and loss Account of Mr. A for the previous year 2019-20.

**PROFIT AND LOSS ACCOUNT**

Rs. Rs.

To Salaries	25,650	By Gross profit	80,000
To Rent	1,000	By Bank interest	450
To Commission on sales	100	By Bad Debts recovered	
To Income – tax	2,600	(Last year allowed)	2,000
To Entertainment expenses	600	By rent from house property	4,800
To commission paid to collect interest on securities	25	By interest on commercial securities	2,000
To Embezzlement by cashier	1,000		
To Municipal tax of H.P.	600		
To bad Debts (allowed)	450		
To Repairs to house	1,625		
To Office expenses	9,180		
To Depreciation	5,000		
L.I.C. premium	1,320		
To Net Profit	<u>40,100</u>		
	<u>89,250</u>		<u>89,250</u>

Depreciation on all assets is Rs. 4500.

Compute taxable business income for the previous year \_\_\_\_\_.

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**C. NO. : BCG -302**  
**SEMESTER -III**

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**UNIT - I**  
**LESSON 1-3**

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**BASIC TERMS**

**STRUCTURE**

- 1.1 Introduction**
- 1.2 Objectives**
- 1.3 Assessment year**
- 1.4 Previous year**
- 1.5 Assesses**
- 1.6 Residential status**
- 1.7 Person**
- 1.8 Income**
  - 1.8.1 Capital Receipts vs Revenue Receipts, Capital Expenses vs Revenue Expenses, Capital Losses vs Revenue Losses.**
- 1.9 Exempted Income**
- 1.10 Summary**

### **1.11 Glossary**

### **1.12 Self assessment questions**

### **1.13 References**

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## **1.1 INTRODUCTION**

---

Income tax is one of the form of Direct Taxes. Tax is the financial charge imposed by the Government on income, commodity or activity. Government imposes two types of taxes namely Direct taxes and Indirect taxes. Direct tax is one where burden of tax is directly on the payer e.g income tax, wealth tax etc. Indirect tax is paid by the person other than the person who utilizes the product or service e.g Excise duty, Custom duty, Service tax, Sales Tax, Value Added Tax. The taxes are collected for serving the primary purpose of providing sufficient revenues to the State, taxes have come to be recognised as an instrument through which the social and economic objectives of a welfare State could be achieved. They are utilized now for providing incentives for larger earnings and more savings, fostering industrial development by selective concessions, restraining ostentatious expenditure, checking inflationary pressures and achieving social objectives like inequalities and the enlargement of opportunities to the common man. Income-tax is one of the major sources of revenue for the Government. The responsibility for collection of income-tax vests with the Central Government. This tax is leviable and collected under Income-tax Act, 1961 (hereinafter referred to as the Act). In India, Income tax was introduced for the first time in 1860, by Sir James Wilson in order to meet the losses sustained by the Government on account of the Military Mutiny of 1857. Thereafter; several amendments were made in it from time to time. In 1886, a separate Income tax act was passed. This act remained in force up to, with various amendments from time to time. In 1918, a new income tax was passed and again it was replaced by another new act which was passed in 1922. This Act remained in force up to the assessment year 1961-62 with numerous amendments. The Income Tax Act of

1922 had become very complicated on account of innumerable amendments. The Government of India therefore referred it to the law commission in 1956 with a view to simplify and prevent the evasion of tax. The law commission submitted its report in September 1958, but in the meantime the Government of India had appointed the Direct Taxes Administration Enquiry Committee which submitted its report in 1956. In consultation with the Ministry of Law finally the Income Tax Act, 1961 was passed. The Income Tax Act 1961 has been brought into force with 1 April 1962. It applies to the whole of India including Jammu and Kashmir. The Income tax Act contains the provisions for determination of taxable income, determination of tax liability, procedure for assessment, appeal, penalties and prosecutions. It also lays down the powers and duties of various income tax authorities. "Income Tax is levied on the total income of the previous year of every person." Every year a Budget is presented before the parliament by the Finance Minister. One of the important components of the Budget is the Finance Bill. The Bill contains various amendments such as the rates of income tax and other taxes. When the Finance Bill is approved by both the houses of parliament and receives the assent of President, it becomes the Finance Act. The CBDT issues notifications from time to time for proper administration of the Income tax Act. These notifications become rules and collectively called Income Tax Rules, 1962. Circulars are also issued by the CBDT to clarify the doubts regarding the scope and meaning of the provisions. These provisions are issued for the guidance of the Income Tax officers and assesses. These circulars are binding on the department, not on the assessee but assessee can take benefit of these circulars. To levy income tax, one must have the understanding of the various concepts related to the charge of tax like previous year, assessment year, Income, total income, person etc.

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## **1.2 OBJECTIVES**

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After going through this unit you will be able to understand

- The concept about the ‘assessment year’ and ‘previous year’ related to the charge of Income tax.
- The term assessee and different categories of assessee for the purpose of charge of Income tax
- The meaning of the residential status for income tax purpose.
- Definition of ‘person’ comes under the purview of the Income Tax Act, 1961.
- The concept of income and various exempted incomes under Income Tax Act, 1961.

### **1.3 ASSESSMENT YEAR [ Section 2 (9 ) ]**

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——“Assessment year” means the period of twelve months commencing on the 1st day of April every year. In India, the Govt. maintains its accounts for a period of 12 months commencing from 1<sup>st</sup> April to 31<sup>st</sup> March of Next year. As such it is known as financial year. The income tax department has also selected the same year for the purpose of assessment procedure.

The assessment year is the financial year of the Govt. of India during which income of a person relating to the relevant previous year is assessed to tax. Every person who is liable to pay tax under this act, files return of income by prescribed dates. These returns are processed by the income tax department officials and officers. This processing is called assessment. Under this income returned by the assessee is checked and verified. Tax is calculated and compared with the amount paid and assessment order is issued. The year in which this process is carried out is called assessment year. Current assessment year is 2020-21.

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## **1.4 PREVIOUS YEAR [SECTION 2 (34) ]**

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“previous year” means the financial year immediately preceding the assessment year: Provided that, in the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year.

The term previous year is very important because it is the income earned during previous year which is to be assessed to tax in the assessment year. As the word “previous” means coming before, hence it can be simply said that the previous year is the financial year preceding the assessment year e.g. for assessment year 2020-21, the previous year should be the financial year ending on 31<sup>st</sup> March, 2020. Understanding concept of previous year is very simple, it’s basically a period of up to 12 months just preceding the assessment year. Since, financial year is always a period of 12 months and income or source of income may be smaller than of 12 months, so the concept or term of previous year is used under Income Tax to cover income or source of income coming into existence after the commencement of financial year and to cover income or source of income coming to an end before completion of the financial year. Either, way any income or source of income is not required to be spread to the whole of financial year, it may be part of the same and the same may be called a previous year. Current Previous Year is 2018-19

### **When Previous Year and Assessment Year are the Same**

Though income of previous year is taxed in the immediately following assessment year, in the following cases, income of previous year is taxable in the same year, that is, previous year and assessment year are the same:

#### **a) Income of non- resident from shipping business**

If a non-resident owns a ship that carries passengers, livestock, mail or goods from a port in India, he has to furnish a return of income on the amount of

carriage earned from the passengers, livestock, mail or goods since the last arrival of the ship. If, for some reason, the owner of the ship cannot furnish the return before the departure of the ship, someone authorized on his behalf, can pay the tax and file the return within 30 days of departure of the ship. Clearance at the sea port will be given to the ship only after tax has been duly paid by the assessee or necessary arrangements have been made for the same.

**b) Income of persons leaving India**

If it appears to the Assessing Officer that an individual may leave India during the current Assessment year (say, 2009-10) or shortly after its expiry (say, 20th April, 2010) with no intention of coming back to India, income of that individual up to the date of departure (20/4/10) shall be chargeable to tax in the assessment year 2009-10. Thus, in the Assessment year, 2009-10, that individual will be subject to assessment for

- income of the previous year 2008-09 at the rates applicable for the Assessment year 2009-10
- income of the period 1/4/09-31/3/10 at the rates applicable for the assessment year 2010-11. (Part I, First schedule, Finance Act, 2010)
- \ • income of the period 1/4/2010-20/4/2010 at the rates applicable for the 2010-11 (part I, first schedule, Finance Act 2010).

**c) Income of bodies (association of persons, body of individuals, artificial juridical person) formed for a specific event or purpose**

If it appears to the Assessing officer that these bodies are formed for a specific purpose and are likely to be dissolved in the assessment year in which they are formed or in the next assessment year, total income of such bodies will be chargeable to tax in that assessment year only at rates applicable for specific assessment years.

### **ILLUSTRATION**

Mr. Arun Passed his MBA examination in June, 2019 and joined his job on 1<sup>st</sup> July, 2019 on a salary of Rs 20,000 p.m. He resigned from his job on 15<sup>th</sup> November, 2019, and got relieved on 30<sup>th</sup> November, and started his own business on 15 December, 19 and earned a profit of Rs 60,000 up to 31<sup>st</sup> March, 2020. Find out his taxable income.

Solution :

First previous year of Mr. Arun shall be as under: -

For salary income : From 1/07/2019 to 31/ 11/ 2020 i.e., 5 months

For business income: 15/12/2019 to 31/03/2020 i. e., 3 ½ months

Taxable income for the previous year 2019- 20 shall be from salary for 5 months @ 20,000 p.m. i.e., Rs 100,000 plus from business Rs 60,000 = Rs 160,000

This income of Rs 160,000 of Mr. Arun will be put to tax in the assessment year 2020-21 as income of a previous year is taxed in an assessment year relevant to the previous year and it is taxed as per rates applicable to the relevant assessment year.

**d) Income of persons who transfer their property to avoid tax**

If it appears to the Assessing Officer that any person is likely to transfer his property to avoid payment of tax, he will assess total income of such person for that previous year from 1st of April up to the date when Assessing officer commences proceedings at the rates applicable for that assessment year only.

e) **Income of a discontinued business [ Section 176]**

In case any business or profession is discontinued during an assessment year , the income of the period from the expiry of last previous year till the date of discontinuation may be assessed to tax in the current assessment year at the discretion of the assessing officer

**Previous Year in Case of a Continuing Business**

It is the financial year proceeding the assessment year. As such for the assessment year 2020-21, the previous year for a continuing business is 2019-20 i.e. 1-04-2019 to 31-03-2020.

**Newly Set Up Business or Profession**

The assessee is free to set up a new business or profession on any day and the first previous year in case of a newly set up business/profession or newly created source of income shall be on the day it is set up and end on 31<sup>th</sup> March next following. So the first previous year may be of 12 months but all subsequent previous year shall be of 12 months duration and always be starting on 1<sup>st</sup> April each year.

For example, if a new business / profession is set up on 15<sup>th</sup> September, 2019 then the first previous year shall be from 15/09/2019 to 31/03/2020 i.e., the first previous year shall be only of 6 ½ months.

**In Case of Newly Created Source of Income**

In such case the previous year shall be the period between the day on which such source comes into existence and 31<sup>st</sup> March next following year.

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**1.5 ASSESSEE [ Section 2 (7)]**

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Assessee” means a person by whom any tax or any other sum of money is payable under Income Tax Act 1961 and includes—

- (a) every person in respect of whom any proceeding under this Act has been taken for assessment of his income or assessment of fringe benefits or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person ;
- (b) every person who is deemed to be an assessee under any provision of this Act.
- (c) every person who is deemed to be an assessee in default under any provision of this Act.

**a. Ordinarily Assessee**

- any person against whom proceedings under Income Tax Act are going on, irrespective of the fact whether any tax or other amount is payable by him or not;
- any person who has sustained loss and filed return of loss u/s 139(3);
- any person by whom some amount of interest, tax or penalty is payable under this Act;
- any person who is entitled to refund of tax under this Act.

**b. Representative Assessee or Deemed Assessee**

A person may not be liable only for his own income or loss but he may also be liable for the income or loss of other persons e.g. agent of a non-resident, guardian of minor or lunatic etc. In such cases, the person responsible for the assessment of income of such person is called representative assessee. Such person is deemed to be an assessee.

- In case of a deceased person who dies after writing his will the executors of the property of deceased are deemed as assessee.
- In case a person dies intestate (without writing his will) his eldest son or other legal heirs are deemed as assessee.

- In case of a minor, lunatic or idiot having income taxable under Income tax Act, their guardian is deemed as assessee.
- In case of a non-resident having income in India, any person acting on his behalf is deemed as assessee.

**c. Assessee-in-default**

A person is deemed to be an assessee-in-default if he fails to fulfill his statutory obligations. In case of an employer paying salary or a person who is paying interest, it is their duty to deduct tax at source and deposit the amount of tax so collected in Government treasury. If he fails to deduct tax at source or deducts tax but does not deposit it in the treasury, he is known as assessee-in-default.

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**1.6 RESIDENTIAL STATUS**

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In India, as in many other countries, the charge of income tax and the scope of taxable income varies with the factor of residence. Tax is levied on income of assessee. Under the provisions of income tax act, 1961 the total income of each person is based upon his residential status. Section 6 of the act divides the assessable persons into three categories: (i) ordinary resident; (ii) resident but not ordinarily resident; and (iii) non- resident. Each of the two tests relate to the physical presence of the taxpayer in India in the course of the “previous year” which would be the twelve months from April 1 to March 31.

A person is said to be “resident” in India in any previous year if he

- a. is in India in that year for an aggregate period of 182 days or more; or

- b. having within the four years preceding that year been in India for a period of 365 days or more, is in India in that year for an aggregate period of 60 days or more in that relevant previous year.

The above provisions are applicable to all individuals irrespective of their nationality. However, as a special concession for Indian citizens and foreign citizens of Indian origin, the period of 60 days referred to in Clause (b) above, will be extended to 182 days in two cases: (i) where an Indian citizen leaves India in any year for employment outside India; and (ii) where an Indian citizen or a foreign citizen of Indian origin (NRI), who is outside India, comes on a visit to India.

In the above context, an individual visiting India several times during the relevant “previous year” should note that judicial authorities in India have held that both the days of entry and exit are counted while calculating the number of days stay in India, irrespective of however short the time spent in India on those two days may be.

A “non-resident” is merely defined as a person who is not a “resident” i.e. one who does not satisfy either of the two prescribed tests of residence.

An individual, who is defined as Resident in a given financial year is said to be “not ordinarily resident” in any previous year if he has been a non-resident in India 9 out of the 10 preceding previous years or he has during the 7 preceding previous years been in India for a period of, or periods amounting in all to, 729 days or less.

Till 31st March 2003, “not ordinarily resident” was defined as a person who has not been resident in India in 9 out of 10 preceding previous years or he has not during the 7 preceding previous years been in India for a period of, or periods amounting in all to, 730 days or more.

## **In the case of an individual [Section 6 ]**

**1. Resident ( Ordinary Resident)[ Section 6 (10 r.w. Section 6 (6) (a) & (b) :** Section 6 (1) of the Income-tax Act, 1961, prescribes the tests for determining the residential status of a person. As individual who fulfills any one of the following two tests is called resident under the provisions of this act. These tests are:

- (1) An individual is said to be resident in India in any previous year, if he
  - a. is in India in that year for a period or periods amounting in all to one hundred and eighty-two days or more;
  - or
  - b. having within the four years preceding that year been in India for a period or periods amounting in all to three hundred and sixty five days or more, is in India for a period or periods amounting in all to sixty days or more in that relevant previous year.

Resident = Satisfying any one of the two conditions given u/s 6 (1).

### **Explanation :**

- (a) In case of individual being a citizen of India who leaves India in any previous year as a member of the crew of an Indian ship as defined in clause (18) of section 3 of the merchant shipping act 1958 ( 44 of 1958) or for the purposes of employment outside India the previous of sub- clause (b) as given above shall apply in relation to that year as if the words “ sixty days “ have been substituted by 182 days.
- (b) In case of an individual being a citizen of India or a person of Indian origin within the meaning of explanation to clause (e) of section 115 C who being outside India, comes on a visit to India in any previous year,

the provisions of sub- clause (b) shall apply in relation to that year as if for the words. 60 Days occurring therein the words 182 days had been substituted.

After substituting one of the above two tests, an individual becomes resident of India but to become an ordinary resident of India an Individual has to fulfill both the following two conditions:

- (1) He has been resident of India ( Fulfilling at least one test given above ) in at least 2 previous years out of 10 previous years immediately prior to the previous year in question.
- (2) He has stayed in India for at least 730 days in 7 previous years immediately preceding the previous year in question.

This means that an individual will not become an ordinary resident of India by simply staying in India for a period of 182 days or more in a previous year. He will become Ordinary resident only if he fulfills one of these two tests and was also fulfilling one of the tests in at least 2 previous years preceding the relevant previous year and did stay in India for at least 730 days in 7 previous years preceding the relevant previous year.

While calculating number of days for stay in India, days of departure was not included. But now as per decision of Authority for advance rulings , both day of departure from India and day of arrival in India are to be counted as stay in India.

**2. Resident but not Ordinarily Resident [ Section 6 (6)]** An individual who is resident u/s 6 (1) can claim the beneficial status of N.O.R if he can prove that:

- (a) He was non resident of India for 9 Previous years out of 10 previous years preceding the relevant previous year

- (b) He was in India for a period or periods aggregating in all to 729 days or less during 7 previous years preceding the relevant previous year.

An individual who is resident u/s 6 (1) can be subdivided into two categories: (a) ordinary resident and (b) not ordinarily resident.

**3. Non – Resident** [ Section 2 (30)]: Under section 2 (30) of the income tax act, 1961 an assessee who does not fulfill any of the 2 conditions given in section 6 (1) (a) or (b) would be regarded as non- resident assessee during the relevant previous year for all purposes of this act.

Non – resident = Not satisfying any one of the basic conditions given u/s 6 (1).

**A Hindu undivided family [ Section 6 (2) r.w Section 6 (6) (a) & (b)]**

Firm or other association of persons is said to be resident in India in any previous year in every case except where during that year the control and management of its affairs is situated wholly outside India. HUF, is said to be resident in every year case except where during the year the control and management of its affairs is situated wholly outside India. It means that If a HUF is controlled from India even partially it will be resident assessee.

The control and management of affairs refers to the controlling and directing Power, the head and the brain. It means that decisions making power for vital affairs is situated in India. The control and management means de-facto control and management and not merely the right to control or manage.

Resident = control and management of affairs in India ( Wholly or Partially)

A resident HUF is said to be ordinary resident, if the karta fulfills both of the following additional conditions:

- (1) Karta has been resident in India for at least 2 Previous years of immediately preceding 10 previous years relevant to current previous year and

- (2) Karta has been in India for 730 days or more during 7 previous years preceding the relevant previous year.

Ordinary resident = Control and Management of affairs in India ( Wholly or partially) + Fulfillment of both additional conditions by Karta.

**2. Not Ordinarily Resident [ Section 6(2) r.w . Section 6 (6) (a) & (b)]**

It is only HUF besides individual which can claim the advantageous state of Not Ordinarily Resident. A HUF will be “ Not Ordinarily Resident” if :

- (i) Its manager ( karta) has not been resident in India in at least 2 previous years out of 10 previous years preceding the relevant accounting year.

Or

- (ii) The manager had not, during the 7 previous years preceding the relevant previous year been present in India for a period or periods amounting in all to 730 days . [ Section 6 (6) (b)].

These two tests have to be applied in case of manager ( Karta) of such HUF. In case the karta has been succeeded by some other man, for computing the presence in India, the length of presence in India of each Succeeding Karta will be added.

While determining the residential status of a HUF it should be noted that residential status of co- parcners of a HUF is of immaterial consideration. What is important to note is that from where the business of HUF is being controlled.

Not ordinarily resident status of HUF is linked with the status of its karta. So, if Karta taken as an individual is not ordinarily resident then the status of his HUF shall also be not ordinarily resident.

3. **Non Resident [ Section 2(30) ]:** HUF , shall be non- resident in India if the control and management of affairs is supplied wholly outside India.

### **Resident status of firm and AOP, Or BOI**

1. **Resident /Ordinary Resident [ Section 6 (2)]:** A firm , an association of Persons or body of individuals is said to be resident in every case except where during that year the control and management of its affairs is situated wholly outside India. It means that if A firm, an association of persons or body of individuals is controlled from India even partially it will be resident assessee.

The control and management of affairs refers to the controlling and directing power, the head and the brain. It means that decision making power for vital affairs is situated in India. The control and management means de-facto control and management and not merely the right to control or manage.

In case of a firm, it is said that the control and management of firm is situated at a place where partners meet to decide the affairs of the firm. If such place is outside India, it will be said that the control and management is outside India.

There may be a situation where all the partners of a firm are resident in India but even then that firm may be non- resident if its full control and management lies outside India.

2. **Not ordinarily resident :** A firm, an association of persons or body of individuals cannot claim the status of not ordinarily resident. All these assessee shall be either resident in India or non- resident in India.
3. **Non- Resident [ Section 2 (30)] :** A firm or association of persons shall be non- resident if the control and management of affairs is situated wholly outside India.

### **Residential status of a company :**

Residential status of a company is to be determined on the basis of its incorporation or registration. Section 6 (3) provides the following tests in this connection.

1. **Resident [ Section 6 (3)]:** A company shall be said to be resident in India, in any previous year, If
  - (a) It is an Indian company or
  - (b) Its place of effective management , at any time in that year , is in India.

For this purpose, the expression “:Place of effective management” shall mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are , in substance made.

2. **Not ordinarily resident :** A Company cannot have this status. It can either be resident or non- resident.
3. **Non – resident :** A company shall be non- resident if it is not resident in India during the relevant accounting year. It means that a company whose control and management is situated wholly or partially outside India, will be non-resident company.

### **Any other person**

Every other person includes body of individuals , a local authority and an artificial juridical person. They are either Resident or Non- Resident but they cannot be Not Ordinarily Resident. The test to be applied shall be the of control and management . If it is situated wholly outside India , the assessee will be non-resident. If the control and management is wholly or partially situated in India, the Status will be that of Resident.

## Incidence of Tax ( Scope of Total Income)

The tax is levied on total income of a person. The total income is based upon the residential status of an assessee. Section 5 Provides the scope of total income which varies on the basis of status. Section 5 provides:

1. Subject to the provisions of this act, the total income for any previous year of a person who is resident includes all incomes from whatever source derived, which
  - (a) is received or is deemed to be received in India in such year by or on behalf of such person or
  - (b) accrues or arises or is deemed to accrue or arise to him in India during such year or
  - (c) accrues or arises to him outside India during such year

provided that , in the case of a person not ordinarily resident in India within the meaning of sub- section ( 6) of section 6 the income which accrues or arises to him outside India shall not be included unless it is derived from business controlled in or a profession set up in India.

2. Subject to the provisions of this act, the total income of any previous year of a person who is non- resident includes all incomes from whatsoever source derived , which.
  - (a) Is received or is deemed to be received in India in such year by or on behalf of such person or
  - (b) Accrues or arises or is deemed to accrue or arise to him in India.

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### **1.7 PERSON [Section 2(31)]**

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Income-tax is charged in respect of the total income of the previous year of every person. Hence, it is important. To know the definition of the word person. As per section 2(31), Person includes:

- an individual:
- a Hindu undivided family:
- a company
- a firm
- an association of persons or a body of individuals whether incorporated or not:
- a local authority:
- every artificial, juridical person, not falling within any of the above categories

### **An individual**

A natural human being, i.e. male, female, minor or a person of sound or unsound mind.

### **A Hindu undivided family**

It consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. It is a relationship created due to operation of hindu law. The manager of HUF is called Karta and its members called coparceneres.

### **A Company**

It is an artificial person registered under Indian companies act 1956 or any other law.

### **A Firm**

It is an entity which comes into existence as a result of partnership agreement between persons to share profits of the business carried on by all or any one of them. Though, a partnership firm does not have a separate entity,

yet it has been regarded as a separate entity under income tax act. Under income tax act, 1961, a partnership firm can be of the following two types:

- (1) A firm which fulfill the conditions prescribed U/s 184
- (2) A firm which does not fulfill the conditions prescribed u/s 184

### **An association of persons or a body of individuals**

The difference between Association of persons and body of individuals is that whereas an association implies a voluntary getting together for a definite purpose, a body of individuals would be just a body without an intention to get-together. Moreover, the members of body of individuals can be individuals only whereas the members of an association of persons can be individual or non-individuals (i.e. artificial persons). There must be common purpose, and common action to achieve common purpose i.e., to earn income. An AOP, can have firms, companies, associations and individuals as its members.

A body of individuals cannot have non- individuals as its members . Only natural human beings can be members of a body of individuals.

Whether a particular group is AOP, or BOI is a question of fact to be decided in each cases separately.

### **A local authority**

It means a municipal committee, panchayat, cantonment board, district board, body of port commissioners, or other authority legally entitled to or entrusted by the Government with the control and management of a Municipal or local fund.

### **Every artificial, juridical person, not falling within any of the above categories**

This is a residuary clause and a public corporation established under special act of legislature and a body having juristic personality of its own are known to be artificial

juridical persons. If the assessee does not fall in any of the first six categories, he is assessed under this clause. Generally, a statutory corporation, deity or charitable institution or an endowment for charitable or religious purposes falls under artificial juridical person. For example

1. Reliance industries ltd - a company
2. Punjab national bank- a company
3. Madras university- artificial juridical peson
4. Calcutta municipal committee – a local authority a
5. A partnership firm – a firm
6. G singh parivar consisting of Mr. A , his brother, Mrs. A and B – A HUF
7. AB publisher ltd. – A Company
8. Markfed, housefed – an association of persons.

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## **1.8 INCOME [ Section 2 (24)]**

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### **General meaning of “INCOME” covered under income tax Act 1961.**

Income Tax Act, 1961 gives the specific definition of the term “income” in section 2(24) which is inclusive and not exhaustive. Before discussing the definition of income given in section 2(24), it is imperative to know meaning of “income” as generally understood. The term income simply means something which comes in. It is a periodical return with regularity or expected regularity. Income does not only refers to monetary return but also includes non-monetary returns. It includes value of benefits and perquisites as well. All such incomes are to taxed unless otherwise it is specifically exempted by any such provisions of the Act. Income includes:

1. Profits and gains

2. Dividend
3. Voluntary contribution received by a trust: Voluntary contribution received by a trust are included in the definition of income. As such contributions received by following types of trusts, funds, associations, bodies, etc are included in the income of such bodies.
  - (a) Contributions received by a trust created wholly or partly for charitable or religious purposes.
  - (b) Contributions received by a scientific research association.
  - (c) Contribution received by a fund or institution set up for charitable purposes and notified u/s 10 (23 c) (iv) (v).
  - (d) Contribution received by any university or other educational institutions , hospitals referred in section 10 (23 c).
4. The value of any perquisite or profit in lieu of salary taxable under section 17 (2) (3).
5. Any special allowance or benefit, other than perquisite included under sub clause (iii), specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.
6. Any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.
7. Value of any benefit or amenity, whether convertible into money or not, obtained by a representative assessee or by any person on whose behalf such benefit is received by representative assessee and sum paid by

representative assessee in respect of any obligation which but of such payment would have been payable by the person on whose behalf representative assessee has made such payments.

8. The profits and gains of any business of banking including providing credit facilities, carried on by a co- operative society with its members.
9. The value of any benefits or perquisites, whether convertible into money or not, obtained from a company either by a director or by a person, who has a substantial interest in the company or by a relative of a director of such person, and any sum paid by such company in respect of any obligation but for which, such payment would have been payable by the director or other person aforesaid.
10. Any sum chargeable to income tax under section 28 (ii) and (iii) or section 41 or section 59.
11. Any sum chargeable to tax u/s 28 (iii a)
12. Any sum chargeable to tax u/s 28 (iii b)
13. Any sum chargeable to tax u/s 28 (iii c)
14. The value of any benefit or perquisite taxable under section 28 (iv)
15. Any capital gain taxable under section 45
16. An aggregate amount of gift or gifts received ( whether in cash or in the form of property) exceeding Rs 50,000 in a previous year by an individual or HUF from non- relatives as referred to u/s 56 (2) (vii).
17. Gifts received by a firm or closely held company as provided in section 56 (2) ( vii a)
18. Any sum of money or value of property referred to in section 56 (2) (x)[ w.e.f A.Y 2020-21]

**Features:**

- a) **Regular and definite source** – The term “income” connotes a periodical monetary return coming in with some sort of regularity or expected regularity from definite sources.
- b) **Income must come from outside** – No one can earn income from himself. There can be no income from transactions between head office and branch office. Contributions made by members for the mutual benefit and found surplus cannot be termed as income of such group.
- c) **Receipt vs. accrual** – Income arises either on receipt basis or on accrual basis. Income may accrue to a taxpayer without its actual receipt. Moreover, in some cases, income is deemed to accrue or arise to a person without its actual accrual or receipt.
- d) **Tainted income** – The income-tax law does not make any distinction between income accrued or arisen from a legal source and income tainted with illegality. Assessment of illegal income does not grant him immunity from the applicability of the provisions of other Act.
- e) **Disputed title** – Income-tax assessment cannot be held up or postponed merely because of existence of a dispute regarding the title of income.
- f) **Temporary or permanent** – Whether the income is permanent or temporary, it is immaterial from the tax point of view. Even temporary income is taxable.
- g) **Diversion of income by overriding title vs. application of income** — Any expenditure/ investment, after income is received, is application of income. “Income” under the Income-tax Act, which is chargeable to tax, is income before application of income. Any expenditure investment out of such income is deductible only if it is permitted by a provision under the Income-tax Act or Income-tax rules. Diversion of income means that a part of the income or

whole of such income does not reach to assessee. It is diverted to some other person due to some legal obligation.

- h) Lump sum receipt** — Income, whether received in lump sum or in instalments, is liable to tax. For instance, arrears of bonus, received in lump sum, is income and is taxable as salary.
- i) Tax-free income** – If a person receives tax—free income on which tax is paid by the person making payment on behalf of the recipient, it has to be grossed up for inclusion in his total income.
- j) Voluntary receipts** – The receipts which do not arise from the exercise of a profession or business or do not amount to remuneration and are made for reasons purely of personal nature are not included in the scope of total income. Receipt on account of dharmada, gaushala, and pathshala is not income and, therefore, not liable to tax.
- k) Income includes loss** – Income includes loss. While income, profits and gains represent “plus income”, losses represent “minus income”.
- l) Treatment of gifts** – In case of individual or H.U.F., subject to certain exceptions, the following three kinds of gifts are treated as income under the head other sources u/s 56(2)(vii) ;
  - A) Monetary gifts:** Any sum of money received from any person or persons without consideration exceeding Rs.50000 in aggregate during a previous year, then

INCOME = THE WHOLE OF SUCH SUM OF MONEY

- B) Gift of immovable property:** Any immovable property received from any person without consideration having stamp duty value exceeding Rs.50000, then

INCOME = THE STAMP DUTY VALUE OF SUCH IMMOVABLE PROPERTY

C) **Gift of property (specified) other than immovable property**

- a) without consideration: Any property (specified) other than immovable property received from any person without consideration, the aggregate F.M.V of which exceeds Rs.50,000, then

INCOME = THE WHOLE OF THE AGGREGATE F.M.V OF SUCH PROPERTY

- b) **For inadequate consideration:** Any property (specified) other than immovable property received from any person for inadequate consideration i.e., for a consideration less than the aggregate F.M.V. of the property and such consideration is less than the aggregate F.M.V of the property by an amount exceeding Rs.50000, then  
INCOME = THE AGGREGATE F.M.V OF SUCH PROPERTY – ACTUAL CONSIDERATION

However, the above gift received from a relative, On the occasion of marriage of individual, under will/inheritance, in contemplation of death of the payer, received from specified funds/institutions are not treated as income of the recipient.

In general terms, Income is a periodical monetary return with some sort of regularity. However, the Income Tax Act, even certain income which does not arise regularly are treated as income for tax purposes e.g. Winnings from lotteries, crossword puzzles. It includes:

**a. Cash or kind**

Income may be received in cash or kind. When the income is received in kind, its valuation will be made in accordance with the rules prescribed in the Income-tax Rules, 1962.

**b. Receipt basis/ Accrual basis**

Income arises either on receipt basis or on accrual basis. It may accrue to a taxpayer without its actual receipt. The income in some cases is deemed to accrue or arise to a person without its actual accrual or receipt. Income accrues where the right to receive arises.

**c. Legal or illegal source**

The income-tax law does not make any distinction between income accrued or arisen from a legal source and income tainted with illegality.

**d. Temporary/Permanent**

There is no difference between temporary and permanent income under the Act. Even temporary income is taxable under Income Tax Act.

**e. Lump sum/instalments**

Income whether received in lump sum or in instalments is liable to tax. For example: arrears of salary or bonus received in lump sum is income and charged to tax as salary.

**f. Gifts**

Gifts of personal nature do not constitute income subject to maximum of ₹50,000 received in cash. The recipient of gifts like birthday, marriage gifts, etc., is not liable to income-tax as received in kind however as per the Finance Act, 2009 gifts in kind having fair value upto Rs 50,000 are not liable to tax but having fair value of more than Rs 50,000 is wholly taxable.

**g. Revenue or Capital receipt:**

Income-tax, as the name implies, is a tax on income and not a tax on every item of money received. Therefore, unless the receipt in question constitutes income as distinguished from capital, it cannot be charged to tax. For this purpose, income should be distinguished from capital which gives rise to income. However, some capital receipts have been specifically included in the definition of income.

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**1.8.1 Capital Receipts vs Revenue Receipts, Capital Expenses vs Revenue Expenses, Capital Losses vs Revenue Losses.**

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Income Tax is levied on income of assessee and not an every receipt which he receives. The method of charging tax on different types of receipt 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 make the distinction between capital and revenue of vital importance. For this distinguish capital and revenue items can be divided in to 3 sub-parts :

1. Capital Receipts vs Revenue Receipts
2. Capital Expenses vs Revenue Expenses
3. Revenue Losses vs Capital Losses

**A. Capital Receipt Vs Revenue Receipts**

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

is a capital receipt and which one is a Revenue. Some tests, however, can be applied in particular cases.

### **Immaterial considerations**

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

- 1. Receipt in lump sum or in instalments:** Whether any income is received in Lump sum or in instalments, it will not make any difference as regards its nature. e.g., an employee is to get a salary of Rs 1,000 p.m. Instead of this he enters 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 a 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. [ *Rajah Manyain Meenak and Shamma V. C.I.T* ( 1956) 30 I.T.R 286 ]
- 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 the receipt , whether big or small , cannot decided 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 whereas a receipt of only Rs 1,000 may be a capital receipt. Supreme court has ruled in a case *Divencha V. CIT* (48 ITR 222), that 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 transaction, all such considerations are immaterial to decide the nature of the receipt. A capital payment by a dealer may be a revenue receipt in the hands of the recipient. The character of the receipt shall be decided by consideration other than what the parties call it. [ *Divencha V. CIT*]. 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 the 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. [ *Brudies's Trustees v. I.R.* 25 TC. 13,16].
6. **Time of receipt:** The nature of 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 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 difficult from a revenue receipt. Some tests, however, can be applied in particular cases. These tests are:

- a) **On the basis of nature of Assets :** If a receipt is referred to Fixed Asset, it is capital receipt and if it is referable to circulating asset it is revenue receipt. Fixed assets is that with the help of which owner earns profit by keeping it in this possession, e.g. Plant, Machinery, Building or factory etc. Circulating Asset is that with help of which owner earns profits by parting with it and letting others to become its owner, e.g. Stock-in trade. Profit on the sale of Motor Car used in business by an assessee is Capital Receipt whereas the profit earned by an automobile dealer, dealing in cars, by selling a car is his revenue receipt.
- b) **Termination of source of income:** Any sum received in compensation for the termination of source of income is capital receipt, e.g. compensation receive by an employee from its employer on termination of his services is capital receipt.
- c) **Amount received in substitution of income:** Any sum received in substitution of income is revenue receipt.

### **ILLUSTRATION**

‘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.50,000. It was held that damages received are the compensation for the profits which were to be earned. Hence, this is Revenue Receipt.

- d) **Compensation received on termination of Lease or surrender of a Right.** Any amount received as compensation on surrendering a right or termination of any Lease is Capital Receipt where as any amount received for loss of future income is a revenue receipt.

**ILLUSTRATION:** 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.

- e) **Tests as to the purpose of keeping an article:** If a person purchase a piece of sculpture to keep as decoration piece in his house, if sold later on, will bring causal receipt but if the same sculpture is sold by an art dealer it will be his revenue receipt.

### **Examples of capital and revenue receipts**

#### **Capital receipts**

1. Salami or Nazrana received for grant of permanent lease.
2. Compensation received for loss or 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 employee who is wrongly dismissed or a payment received by an employee in lieu of notice.

## Revenue receipts

1. Lump sum royalty received in advance.
2. A “Pugree” Received by the owner of the house property from tenants
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.

## B. Capital Expenses Vs Revenue Expenses

To distinguish a Revenue Expenditure from a Capital Expenditure, the following tests can be applied for this

- (i) **Nature of the assets:** Any expenditure incurred to acquire a Fixed Assets or in connection with installation of Fixed Assets is Capital Expenditure. *Whereas*, 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 discharged a capital liability is a capital expenditure. *Whereas*, expenditure incurred to discharged a revenue liability is Revenue Expenditure, e.g. Amount paid to a contractor for cancellation of contract to construct a factory building is capital expenditure.
- (iii) **Nature of transaction:** If expenditure is incurred to acquire a source of income, it is Capital Expenditure e.g. purchase of patents to produce picture tubes of T.V. sets. *Whereas* expenditure incurred to earn an income is revenue expenditure, e.g. salary to staff, advertisement expenses etc.

- (iv) ***Nature of payment in the hands of payer:*** If an expenditure is incurred by an assessee as a Capital Expenditure, it will remain a capital expenditure even if the amount may be revenue receipt in the hands of receiver, e.g. purchase of motor car by a businessman is capital expenditure in his hands although it is revenue receipt in the hands of car dealer.

### C. **Capital Losses Vs Revenue Losses**

Distinction has to be made between revenue losses and capital losses of the business because under the provisions of this act capital losses are dealt with under the chapter “ capital gain” whereas revenue losses are treated as business losses and as such are treated under the head “ profit and gains of business or profession”. Distinguish has to be made between Revenue Losses and Capital Losses of the business because under the provisions of this Act, Capital Losses can be set off against the Income from Capital Gain only, whereas the Revenue Losses are business losses and as such can be set off against any other income of the assessee.

It is very difficult to distinguish between a Capital Loss and a Revenue Loss on the basis of certain principles.

The main distinguishing points are:

- (i) ***Loss due to sale of assets :*** Where there is loss on selling a Capital Assets, 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 loss.
- (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 , is a 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 :** losses occurring due to theft or embezzlement of misappropriation committed by an employee is revenue loss.

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## 1.9 EXEMPTED INCOMES

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### A. Agriculture Income [Section 10(1)]

Agricultural income from land situated in India is fully exempted.

### B. Any sum received by a Co-parcener from Hindu Undivided Family (H.U.F.) [Section 10(2)]

Any sum received by an individual as a member of a Hindu Undivided Family, where such sum has been paid out of the income of the family, or in the case of any impartible estate, where such sum has been paid out of the income of the estate belonging to the family is fully exempted. This is subject to the provisions of section 64(2). Out of the income of HUF, if a co-parcener gets any sum of money, it is fully 'exempted in the hands of its co-parceners. It is exempted from tax whether the income of HUF was chargeable to tax or not.

**ILLUSTRATION 1.** *HUF earned ' 5,00,000 during the previous year and paid tax on its income. Mr. A, a co-parcener is an employee and earns a salary of ' 20,000 p.m. During the previous year Mr. A also received ' 1,00,000 from HUF. Mr. A will pay tax on his salary income but any sum of money received from his HUF is not chargeable to tax in Mr. A's hands.*

**ILLUSTRATION 2.** HUF earned ₹ 90,000 during the previous year 2013-14 and it is not chargeable to tax. Mr. A, a co-parcener is earning individual income of ₹ 20,000 p.m. Besides his individual income, Mr. A receives ₹ 30,000 from his HUF.

Mr. A will pay tax on his individual income but any sum of money received by him from his HUF is not chargeable to tax in the hands of co-parcener whether the HUF has paid tax or not on that income.

**C. Share of Income from the Firm [Section 10(2A)]**

In case of a person being a partner of a firm, which is separately assessed as such, his share in the total income of the firm shall be fully exempted.

The share of partner in the total income of the firm shall be in same proportion as is given in partnership deed.

**D. Interest paid to Non-Resident [Section 10(4)(i)]**

The amount of interest payable to a non-resident on such securities or bonds as the Central Govt. may, by notification in the Official Gazette, specify in this behalf, including income by way of premium on the redemption of such bonds, shall be exempt from tax. The exemption under this section shall not be allowed on interest on bonds or securities issued on or after 1-6-2002.

**E. Interest to Non-Resident on Non-Resident (External) Account [Section 10(4)(ii)]**

Any income by way of interest on moneys standing to his credit in a Non-Resident (External) Account in any bank in India shall be exempt from

tax in case of an individual who is a person resident outside India or is a person who has been permitted by the RBI to maintain the aforesaid account.

The person residing outside India shall have the same meaning as defined under Foreign Exchange Regulation Act, 1973, FEMA, 1999. This exemption shall not be available on any income by way of interest paid or credited on or after 1-4-2005.

**F. Interest paid to a person of Indian Origin and who is Non-Resident [Section 10(4B)]**

In case of an individual, being a citizen of India or a person of Indian origin, who is nonresident, any income from interest on such savings certificates issued by the Central Government, as Government may specify in this behalf by notification in the Official Gazette, shall be fully exempt. The exemption under this section shall not be allowed on bonds or securities issued on or after 1-6-2002.

This exemption shall be allowed only if the individual has subscribed to such certificates in Foreign Currency or other foreign exchange remitted from a country outside India in accordance with the provisions of the Foreign Exchange Act, 1973, FEMA, 1999 and any rules made there under. For this purpose, a person shall be deemed to be of Indian origin if he or either of parents or any of his grandparents, was born in India or in undivided India.

**G. Travel Concession to an Indian Citizen Employee [Section 10(5)]**

The provisions of section 10(5) relating to leave travel concession have been completely changed with effect from 1-4-89, i.e., assessment year 1989-90 by the Direct Tax Law (Second Amendment Act 1989) which are as follows:

- (a) Value of any travel concession or assistance received by or due to an individual from his employer for himself and his family in connection with his proceeding on leave to any place in India. OR

- (b) Value of any travel concession or assistance received by or due to an individual from his employer or former employer for himself and his family in connection with his proceeding to any place in India after retirement from service or after the termination of his service shall be completely exempt from tax subject to conditions given below :
- The concession must have been allowed having regard to the travel concession or assistance granted to the Central Govt. employees.
  - In no case the exempted amount shall exceed the amount of expenses actually incurred for the purpose of this travel.
  - The term 'Family' shall mean
    - The spouse and children of the individual ; and
    - The parents, brothers and sisters of the individual or any of them wholly or mainly dependent on the individual.

The following new rules have been incorporated for journeys performed on or after 1-10-97

- (i) **In case journey is performed by air:** Leave travel concession shall be exempted upto an amount not exceeding the **air economy fair of the National Carrier** by the shortest route to the place of journey.
- (ii) **In case journey is performed by any mode other than by air:** If place of origin of journey and place of destination are connected by rail but journey is performed by any mode other than by air, the benefit shall be exempted up to an amount not exceeding air conditioned first class rail fare by the shortest route to the place of destination.
- (iii) **In case place of origin of journey and place of destination are not connected by rail.**

The benefit shall be exempted as following:

- (a) where a recognised public transport system exist, it shall be exempted upto an amount equal to first class or deluxe class fare, as the case may be, on such transport by shortest route to the place of destination.
- (b) where no recognised public system of transport exists the exempted amount shall not exceed the air conditioned first class fare for the distance of journey by shortest route as if journey is performed by rail.

**H. Remuneration received by an individual who is not a citizen of India  
[Section 10(6)]**

The following incomes are exempt when received by an individual who is not a citizen of India:

**(i) Remuneration [U/s 10(6)(ii)].**

- (a) The remuneration received by an ambassador or other officials of the Embassy, High Commission or Legation of a foreign State in India.
- (b) The remuneration by a consular officer of a foreign State in India.
- (c) The remuneration received by a trade commissioner or other official representative in India of a foreign State, provided corresponding officials of the Government of India in that country are given a similar concession.
- (d) The remuneration received by a member of the staff of any of the officials referred to in (a), (b) and (c) above.

If the person mentioned above in (a) to (d) is a subject of the country represented, is not engaged in any business, profession or employment in India (otherwise than as a member of such staff), and the country represented gives similar

concession to the members of the staff of corresponding officials of the Government of India.

**(ii) Remuneration received by him as an employee of foreign enterprise [U/s 10(6) (vi)]**

(e.g., technician deputed by a foreign firm to work in India), for service rendered by him during his stay in India provided the following conditions are fulfilled—(a) the foreign enterprise is not engaged in any trade or business in India; (b) his stay in India does not exceed in the aggregate a period of 90 days in such previous year ; and (c) such remuneration is not liable to be deducted from the income of the employer chargeable under the Act.

**(iii) Employment on a foreign ship [U/s 10(6) (viii)].**

Any income chargeable under the head “Salaries” received by or due to any such individual being a non-resident, as remuneration for service rendered in connection with his employment on a foreign ship where his total stay in India does not exceed in the aggregate of a period of 90 days in the previous year.

**(iv) Remuneration received by an employee of foreign govt. during his stay in India for his training in India [U/s 10(6) (xi)].**

Such remuneration shall be fully exempted if he is taking training in any of the following concern

- (a) Institution owned by Govt.
- (b) A company wholly owned by Central or State govt. or partly owned by Central and partly by State Govt.
- (c) A subsidiary Co. of company referred at point (b) above

- (d) Any corporation established by or under Central, State or Provincial Act
- (e) Any society registered under Societies Registration Act; 186Q and which is wholly financed by Central or State Govt.

**I. Tax paid by Government or Indian concern on Income of a Foreign Company [Section 10(6A), (6B), (6BB) and (6C)] (6A):**

- (i) Where a foreign company renders technical services to Government of India or to a State Government or to an Indian enterprise and for such services a foreign company is paid income by way of royalty or fees.
- (ii) Such fees or royalty is paid by an India concern in pursuance of an agreement entered into before 1-6-2002 and such agreement is approved by Government of India and it is in accordance with the Industrial Policy of the Government of India.
- (iii) Since royalty or fees paid to a foreign company accrues in India, so such income is liable to be taxed in India and as per agreement the payer of income in India pays tax liability of the foreign company.
- (iv) Tax so paid by Government of India or a State Government or an Indian enterprise will be exempted *i.e.*, it will not be grossed up with the income of the foreign company.

***ILLUSTRATION:*** *A foreign company renders technical services to an Indian company and as per agreement, foreign company is to be paid a fees of 1,00,000. Tax of Rs 30,000 on such fees is also paid by the Indian company. Tax paid by Indian company will be exempt and so it will not be grossed up with the income of the foreign company and such foreign company's income will be only Rs 1,00,000.*

**(6B)**

The tax liability of a non-resident (Not being a company) or a foreign company if paid by an Indian concern or Government of India or a State Government the same will be exempted and so will not be grossed up with the income of the foreign entity.

**(6BB) Tax paid on income received by foreign government or a foreign enterprise on leasing aircraft**

In case any income is received by a foreign government or a foreign enterprise from an Indian company which is engaged in the operation of aircraft and such income is by way of consideration of acquiring an aircraft or an engine of aircraft (other than payment for providing spares or services in connection with the operation of leased aircraft) on lease under an agreement entered into after 31-3-1996 but before 1-4-2007 and approved by the Central Government in this behalf, and the tax on such income is payable by such Indian company under the terms of agreement, the tax so paid shall be fully exempted.

This benefit shall be available only to that foreign enterprise which is non-resident.

**(6C)**

Any income derived by a foreign company (so notified by Central govt.) by way of royalty or fees for technical services under an agreement for providing services in or outside India in projects connected with security of India shall be fully exempted.

**J. Perquisites and Allowances paid by Government to its Employees serving outside India [Section 10(7)]**

All the perquisites and allowances paid by the Government to its employees for services rendered outside India, are exempt from tax. This exemption is allowed only to such employees of the Government who are citizens of India.

## **11. Employees of Foreign Countries working in India under Cooperative**

### **Technical Assistance Programme [Section 10(8)]**

The persons who are working in India under co-operative technical assistance programmes accordance with an agreement entered into by the Central Government and the Government of a foreign State, the following incomes of such individuals shall be exempt provided the terms of agreements provide for such exemption

1. the remuneration received by him directly or indirectly from the Government of the foreign State for such duties rendered in India ; and
2. any other income of such individual which accrues or arises outside India and is not deemed to accrue or arise in India, in respect of which individual is required to pay any income or social security tax to the Government of that foreign State.

### **K. Income of a Consultant [Section 10(8A)]**

Any remuneration or fee received by a consultant from an international organisation who derives its fund under technical assistance grant agreement between such organisation and the Foreign Government, and any other income accruing or arising to him outside India (which is not deemed to accrue or arise in India) and which is subject to income-tax or social security tax in foreign country, shall be fully exempted. The agreement of the service of consultant must be approved by the competent authority.

The consultant means :

1. an individual who is (a) not a citizen of India; or (b) if citizen but is not ordinarily resident in India ; or

2. any person who is non-resident ; and is rendering technical services in India in connection with any technical assistance programme or project.

**L. Income of Employees of Consultant [Section 10(8B)]**

In case of an individual who is assigned duties in India under technical assistance programme—

1. the remuneration received by him directly or indirectly from any consultant as referred u/s 10 (8A) above and
2. any other income accruing or arising to him outside India (which is not deemed to accrue or arise in India) and which is subject to income-tax or social security tax in foreign country. shall be fully exempted provided
3. such individual is not a citizen of India ; or
4. if citizen but is not ordinarily resident and
5. the contract of service is approved by the competent authority.

**M. Income of any member of the family of individuals working in India under co-operative technical assistance programmes [Section 10(9)]**

The income of any member of the family of any such individual as referred to under Section 10(8) or (8A) or as the case may be clause 8(B) accompanying him to India, which accrues or arises outside India is not deemed to accrue or arise in India, in respect of which such member is required to pay any income or social security tax to the Government of that foreign State or as the case may be, country of origin of such member.

**N. Gratuity [Section 10(10)]**

- (i) **Death-cum-retirement gratuity**—any such amount received by the employees working on Civil or Defence services of Govt. of India, or on any part of State Govt. or Local authority covered under Revised Pension Rules of the Central Govt. shall be fully exempted.
- (ii) **Gratuity received under Payment of Gratuity Act**—shall be exempted upto an amount as calculated in accordance with the provisions of such Act.
- (iii) **For other employees**—Exempted up to least of the following
  1. Statutory Limit Rs 20,00,000 ( Rs 10,00,000 for those who retired before march 29, 2018)
  2. 1/2 month's average salary for every one completed year of service
  3. Actual gratuity received.

**Average Salary.** : The Direct Tax Laws (Amendment) Act 1987 has revised the definition of average salary. In future average salary is to be calculated on the basis of average of salary received during 10 months preceding the month in which death or retirement occurs.

**Statutory Limit.** : The present ceiling of Rs 20,00,000 is applicable for whole service life of an employee. With effect from assessment year 1989-90 the monetary ceiling will be such limit as the Central Government may by notification in the Official Gazette specify in this behalf keeping in view the limit applicable to Central Government employees.

**Salary :** The word ‘salary’ here has the same meaning as assigned to it for provident fund purposes, i.e., the Basic Pay plus dearness pay plus any portion of D.A. which enters into pay for service benefits.

**O. Commuted value of pension received [Section 10(I0A)]**

- (i) The full amount of commuted value of pension received is exempted if it is received from the Government, a local authority or a statutory corporation.
- (ii) Any payment in commutation of pension received under any scheme from any other employer to the extent it does not exceed
  - 1. in a case where the employee receives any gratuity, the commuted value of **1/3rd** of pension which he is normally entitled to receive ; and
  - 2. in any other case the commuted value of **1/2** of such pension.

**P. Amount received as leave encashment on retirement [Section 10(10AA)]**

- (a) Central & State Govt. Employees—any payment received as the cash equivalent of the leave salary in respect of the earned leave at his credit at the time of his retirement shall be fully exempt.
- (b) Other Employees—any payment received as the cash equivalent of the leave salary at his credit at the time of superannuation shall be exempt upto least of the following four amounts
  - (a) Actual amount received
  - (b) Amount calculated at average salary of 10 months (average salary means average of salary drawn by employee during 10 months immediately preceding the month of his retirement);

- (c) Cash equivalent of leave salary due at the time of retirement.
- (d) Notified Limit—Rs 3,00,000.

Excess of amount received over the least of the above shall be taxable.

**Q. Retrenchment compensation paid to workmen [Section 10(10B)]**

The Finance Act, 1975 has inserted a new clause 10B in section 10 of Income tax Act which provides that retrenchment compensation received by a workman shall be exempted from Income-tax to the extent such compensation does not exceed

1. Amount calculated in accordance with the provisions of Section 15F(b) of the Industrial Disputes, Act,
2. 1947,
- or
3. 5,00,000, whichever is less.

This exemption will be available only to workmen as defined in Industrial Disputes Act, 1947.

**R. Payment received under Bhopal Gas Leak Disaster (Processing of Claims) Act 1985 [Section 10 (10BB)]**

Any amount received under the provision of such Act or any scheme framed there under shall be fully exempted but in case payment is received against a loss or damage, for which deduction has been claimed earlier, it shall be taxable.

**19A. Compensation received in case of any disaster [Section 10(10BC) ]**

In case an individual or his legal heir receives any compensation on account of any disaster from Central or State Government or from a local authority, the same shall be exempted.

**S. Retirement Compensation from a Public Sector Company or any other Company [Section 10 (10C)]**

Any amount received is receivable by an employee of :

1. a public sector company ; or
2. any other company ; or
3. any authority established under a Central, State or Provincial Act ; or
4. a local authority,
5. a co-operative society, or
6. a university established or incorporated by or under a Central, State or Provincial Act, and an institution declared to be university ` under section 3 of the University Grants Commission Act, 1956 ;  
or
7. an Indian Institute of Technology within the meaning of clause (g) of section 3 of the Institute of Technology Act, 1961 ; or
8. such institute of management as the Central Goyt. may, by notification in the official gazette may specify in this behalf.
9. the Central Government.
10. the State Government.

At the time of his voluntary retirement, or in case of a public sector companies under a scheme of voluntary separation, under a scheme framed in accordance with guidelines issued by the Government and in case of companies or co-operative societies, scheme is approved by Chief Commissioner or Director General of Income-tax, shall be exempted up to (a) Actual Amount received ; (b) 500,000 (c) 3 month's 'salary' for each completed year of service ; or, (d) salary last drawn multiplied by number of months' service is left from date of retirement; whichever is less. In case any exemption is claimed under this clause, the employee cannot claim exemption for the same amount under any other section. The approval of scheme of voluntary retirement from Chief Commissioner of Income Tax or Director General of Income Tax is not necessary w.e.f. assessment year 2001-02.

***Guidelines for the above purpose [Rule 2BA of Income-tax Rules 1962]***

1. The scheme applies to an employee of the company who has completed 10 years of service or 40 years of age.
2. It applies to all employees except Directors of the Company.
3. The scheme has been made to result in overall reduction in the existing strength of the employees of the Company.
4. The vacancy so caused is not to be filled up and retired employee is not to be employed again in another company or concern belonging to the same management.
5. The amount payable is to be calculated as 3 months salary for each completed year of service, or salary at the time of retirement multiplied by the balance months of service left before his date of retirement or superannuation.
6. The employee should not have availed benefit of any other voluntary retirement scheme earlier.

7. The term '*Salary*' shall have the same meanings as it has for provident fund purposes.

**T. 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) shall be fully exempted in the hands of employee.

**U. Any sum received under a life insurance policy [Section 10(10D)]**

Any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy shall be fully exempted in following cases :

1. If any sum received from insurance company on insurance of a dependent handicapped member [under subsection (3) of section 80DD]
2. If any sum received from insurance company when a dependent, or a member of family is suffering from a notified disease [under subsection (3) of section 80DDA]
3. Any sum received under a Key man insurance policy "Key man insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected in any manner whatsoever with the business of the first mentioned person ; or
4. Any sum received under an insurance policy issued on or after the 1st day of April, 2003 but before 1-4-2012 in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured.

5. Any sum received under an insurance policy issued on or after 1-4-2012 in respect of which the premium payable for any of the years during the term of the policy exceeds 10% of the actual capital sum assured. Thus, in case of life insurance policies issued on or after 1-4-2012, the exemption regarding any sum received under a life insurance policy shall be allowed only if premium paid on such a policy does not exceed 10% of the capital sum assured.
6. Any sum received under an insurance policy issued on or after 1-4-2013 on the life of a person with disability (referred u/s 80 U) or Suffering from disease as specified in the rules made u/s 80 DDB in respect of which premium payable for any of the years during the term of the policy exceeds 15 % of the actual capital sum assured [w.e.f assessment year 2014-15].

**Note.** Any sum received in respect of policies covered under points (iv) and (v) above shall be fully exempt if such sum is received on the death of the person (i.e., policy holder).

**Raising the limit of premium for the LIC policies of persons with disability or disease for exemption of sum received [Sec 10(1OD)] [w.e.f A.Y. 2014-15].**

For persons suffering from disability (u/s 80U) or certain diseases, the exemption of any sum received under LIC policy, shall be available if the premium for the policy does not exceed 15% (earlier 10%) of the capital sum assured. The increased limit of premium shall be applicable in respect of LIC policies issued on or after 1-4-2013.

**Amendment in Explanation-1 section 10 (1OD) regarding key man insurance policy.**

A key man insurance policy which has been assigned to a person during its term with or without consideration shall continue to be treated as a

key man insurance policy for the purpose of section 10 (10D).

For the purpose of calculating the actual capital sum assured effect shall be given to the following :

1. of the value of any premiums agreed to be returned, or
2. of any benefit by way of bonus or otherwise over and above the sum actually assured, which is to be or may be received under the policy by any person. [Explanation to sub-section (2A) of section 88 and sub-section 3 of section 80C] .

**V. Payment from Statutory Provident Fund [Section 10(11)]**

Any amount withdrawn from the statutory provident fund is exempt from tax. This provision is applicable on Public Provident Fund also.

**Payment received from Sukanya samridhi account [ Section 10 (11A)]**

Any payment from an account opened in accordance with the sukanya samridhi account rules, 2014 shall be exempted.

**W. Payment from Recognised Fund [Section 10(12)]**

The accumulated balance due and becoming payable to an employee participating in a recognised provident fund, is exempt to the extent provided in rule 8 of part A of the Fourth Schedule .

**Partial exemption of payment from national pension system trust to all subscribers on closure of account or opting out of the pension scheme referred to in section 80 CCD[ Section 10 (12A)]**

Any payment from the national pension system trust to all the subscribers or assesses ( employees as well as non- employees) on closure of account or his opting out of the pension scheme referred to in section 80 CCD, to the extent it does not exceed 40 % of the total amount to him at the time of closure or his opting out of the scheme, shall be exempt from tax.

Note: Up to A.Y 2018-19 , this exemption was available only to employees. However, w.e.f A.Y 2019-20 , this exemption has been extended to all subscribers.

Exemption of partial withdrawal from national pension system trust referred to in section 80CCD [ Insertion of section 10 (12B )] [ w.e.f A.Y. 2018-19].

Any partial withdrawal by an employee from national pension system trust in accordance with the terms and conditions specified under pension fund regulatory development authority act , 2013 and regulations made thereunder, shall be exempt to the extent it does not exceed 255 % of the amount of contributions made by him.

#### **X. Payment from Superannuation Fund [Section 10(13)]**

Any payment from an approved superannuation fund made

1. on the death of a beneficiary ; or
2. to an employee in lieu of or in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement ; or
3. by way of refund of contribution on the death of beneficiary ; or  
by way of refund of contribution to an employee on his leaving the service in connection with which the fund is established otherwise than by retirement age or after a specified age or on his becoming incapacitated prior to such retirement, to the extent to which such payment does exceed the contributions made prior to the commencement of this Act and any interest thereon.
4. by way of transfer to the account of the employee under a pension schemes referred to in section 80 CCD and notified by the central government .

**Y House Rent Allowance [Section 10(13A) Read with Rule 2A]**

**(a) Persons living in rented houses**

Any amount of House Rent Allowance received by the employee from his employer is exempted up to the least of the following limits

1. excess of actual rent paid over 10% of salary
2. an amount equal to 50% of salary where such accommodation is situated in any one of the following places, namely, Bombay, Calcutta, Delhi and Madras and 40% of salary in other towns ; or
3. actual amount of House Rent Allowance received.

**(b) Persons living in their own houses or not paying any rent but getting HRA—**

Full HRA received is taxable. No exemption under this provision. [Inserted by Taxation laws ( Amendment) act, 1984 w.e.f from 1-4-1976].

**Z Any Allowance given for meeting Business Expenditure [Section 10(14)]**

Any such special allowance or benefit, not being in the nature of a perquisite within the meaning of clause (2) of section 17 specifically granted to meet expenses wholly, necessarily and exclusively incurred in the performance of the duties of an office or employment of profit, as the Central Government may, by notification in the Official Gazette, specify, to the extent to which such expenses are actually incurred for that purpose.

1. any such allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at place where he ordinarily resides, or to compensate him for the increased cost of living, as the

Central Government may, by notification in the Official Gazette, specify, to the extent specified in the notification.

2. With effect from 1.4.89, i.e., assessment year 1989-90, the Direct Tax Laws (Second Amendment) Act 1989 has inserted the following proviso :

Nothing given in sub-clause (ii) shall apply to any allowance in the nature of personal allowance granted to the assessee to remunerate or compensate him for performing duties of special nature relating to his office or employment unless such allowance is related to the place of his posting or residence.

**OTHER INCOMES ARE:**

**i) Interest Incomes [Section 10(15)]**

**The following interest incomes due to an assessee are exempt from tax :**

- (ia) Income by way of interest, premium on redemption or other payments on such securities, bonds, annuity certificates, savings certificates, other certificates issued by the Central Government shall be exempted if such notification is issued by Central Government in Official Gazette and shall be subject to such conditions and limits as prescribed in such notification.
- (ii) In the case of an individual or a H.U.F. interest on such Relief Bonds as the Central Government may, by notification in the Official Gazette, specify in this behalf.
- (jib) Interest on such Capital Investment Bonds held by individual or H.U.F. and so notified. The Central Govt. shall not specify any such bonds on or after 1-6-2002.
- (iic) Interest on Relief Bonds issued and notified by the Central Government is fully exempted for an individual and HUF.

- (iid) Interest on such notified bonds issued to non-residents and purchased by them in foreign exchange is fully exempted. With effect from 1-6-2002 the Central Govt. shall not notify any such bonds.
- (iii) Interest on securities held by the Issue Dept. of the Central Bank of Ceylon, constituted under the Ceylon Monetary Law Act, 1949.
- (iiia) Interest payable to any bank incorporated in a country outside India and authorised to perform Central Banking functions in that country on any deposit made by it, with the approval of the Reserve Bank of India, with any Scheduled Bank.
- (iiib) Any interest payable to the Nordic Investment Bank, being a multilateral financial institution constituted by the Governments of Denmark, Finland, Iceland, Norway and Sweden, on a loan advanced by it to a project approved by the Central Government in terms of the Memorandum of Understanding entered into by the Central Government with that Bank on the 25th day of November, 1986.
- (iiic) Interest payable to the European Investment Bank, on a loan granted by it in pursuance of the framework-agreement for financial cooperation entered into on the 25th day of November, 1993 by the Central Government with that Bank.
- (iv) Interest payable—
  - (a) by Government or a local authority on money borrowed by it from sources outside India ;
  - (b) by an industrial undertaking in India on money borrowed by it from such financial institution in a foreign country as is approved in this behalf by the Central Government;
  - (c) by an industrial undertaking in India on any moneys borrowed or debt incurred in a foreign country in respect of its purchase outside India of raw materials or components, plant or machinery, to the

extent of amount calculated at the rate approved by the Central Government in this behalf ;

- (d) by the Industrial Finance Corporation of India established by the Industrial Finance Corporation Act, 1948 or the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 or Export Import Bank of India, or the National Housing Bank ; or the Small Industries Development Bank of India or the Industrial Credit and Investment Corporation of India (a company formed and registered under the Indian Companies Act, 1956) on any moneys borrowed by it from sources outside India, to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf, having regard to the terms of the loan and its repayment
- (e) by any other financial institution established in India or a banking company to which the Banking Regulation Act, 1940 applies (including bank or banking institution referred to in Section 51 of that Act), on any moneys borrowed by it from sources outside India under a loan agreement approved by the Central Government where the moneys are borrowed either for the purpose of advancing loans to industrial undertakings in India for purchase outside India of raw materials or capital plant and machinery or for the purpose of importing any goods which the Central Government may consider necessary to import in the public interest to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf, having regard to the terms of the loan and its repayment

- (f) by an industrial undertaking in India on any moneys borrowed by it in foreign currency from sources outside India under approved loan agreement. The loan agreement is to be approved by the Central Government of India before 1-6-2003. The exempted rate of interest is also to be fixed by the Central Government having regard to the terms of the loan and its repayment ; For the purposes of this sub-clause, the expression “Industrial undertaking” means any undertaking which is engaged in—
- (a) the manufacture or processing of goods ; or
  - (b) the business of generation or distribution of electricity or any other form of power; or
  - (c) the business of providing telecommunication services
  - (d) mining ; or
  - (e) the construction of ships ; or
  - (f) the operation of ships or aircrafts or construction or operation of rail systems.
  - (g) by a schedule bank on deposits in foreign currency where the acceptance of such deposits by the bank is approved by Reserve Bank of India.
  - (g) by a public company whose main object is of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential houses, on any money borrowed by it in foreign currency from outside India upto the rate prescribed by Govt.

For exemption u/s 10(15)(iv) (g) the term interest shall not include interest paid on delayed payment of loan or in default

- (h) by any public sector company in respect of such bonds or debentures. The holder of such bonds or debentures must register his name and the holding with that company.
- 1. by Government on deposits made by an employee of the Central Government or a State Government in accordance with such scheme as the Central Govt. may frame and notify in Official Gazette, out of moneys due to him on account of his retirement whether on superannuation or otherwise.
- (v) Interest on securities held by the Welfare Commissioner Bhopal gas victims Bhopal is the Reserve Bank's SGL—AJC No. SLIDHO48 shall be fully exempted. Interest on any deposits (so notified) held for the benefit of victims of Bhopal gas tragedy held with Reserve Bank of India or any Public Sector Bank shall be fully exempted.
- (vi) Interest on Gold Deposit Bonds issued under the Gold Deposit Scheme 1999 notified by Government.
- (vii) Interest on Bonds
  - 1. issued by a local authority ; and
  - 2. specified by the Central Govt. by notification in the official Gazzete.
- (viii) Interest on saving bank account in a post office is exempt
  - 1. upto ₹ 3,500 in the case of an individual account; and
  - 2. upto ₹ 7,000 in the case of a joint account.
- (ix) Interest on bonds issued by State Pooled Finance Entity and specified by the Central Government by notification in the official Gazettee shall be exempted from Income Ta.

**ii. Lease rental income of a foreign government or foreign enterprise from leasing of aircraft/aircraft engine to an Indian company [Section 10(15A)]**

Such payment made to acquire an aircraft or an aircraft engine on lease (other than for providing spares, facilities or service in connection with this operation of leased aircraft) to foreign govt. or a foreign enterprise under an agreement entered before 1-4-97 and between 1-4-99 to 31-3-07 and approved by Central Government shall be fully exempted.

In case payer of lease rent also pays income tax of the foreign enterprise, the same shall be exempted, i.e., tax paid will not be grossed up with the income of the foreign recipient.

**iii. Scholarship [Section 10(16)]**

The full amount of scholarship granted to meet the cost of education is exempted.

‘Cost of education’ includes not only the tuition fees but all other expenses which are incidental to acquiring education. Scholarship may have been given by Govt., University, Board, Trust, etc. The exemption is irrespective of actual expenditure incurred by the recipient to meet the cost of education.

**iv. Allowance of M.P./M.L.A. or M.L.C. [Section 10(17)]**

Any income by way of:

1. Daily allowance received by M.P./M.L.A. or M.L.C. or any committee thereof is fully exempted.
2. any allowance received by any person by reason of his membership of Parliament under the Members of Parliament (Constituency Allowance) Rules, 1986 is fully exempted

3. Constituency allowance received by any person by reason of his membership of any State Legislature or of any Committee thereof, which the Central Government may notify, is also fully exempted.

**v. Awards Instituted by Government [Section 10(17A)]**

- (i) Any payment made whether in cash or in kind under any awards instituted in the public interest by the Central or State Government or instituted by any other body and approved by the Central Govt. in this behalf shall be fully exempted.
- (ii) Any other reward given by Central or State Government for such purposes as may be approved by the Central Government in this behalf in public interest shall also be fully exempted.

**vi. Pension received by certain winners of gallantry awards [Section 10(18)]**

- (i) Any amount received by an individual as pension shall be exempt if:
  - (a) such individual has been in the service of the Central or State Government, and
  - (b) he/she has been awarded 'Param Vir Chakra' or 'Mahavir Chakra' or 'Vir Chakra' or such other notified gallantry awards.
- (ii) Also, any amount received as family pension by any member of the family of an individual referred above shall be fully exempted.

**vii. Family pension received by family members of armed forces including para military forces [Section 10(19)]**

With effect from the 1st day of April, 2005 family pension received by the widow or children or nominated heirs, as the case may be, of a member of the armed forces (including paramilitary forces) of the Union, where the death of such member has occurred in the course of operational duties,

in such circumstances and subject to such conditions, as may be prescribed shall be fully exempted.

**viii. Income from one palace of a former ruler [Section 10(19A)]**

Annual value of any one palace or a portion of a palace in the occupation of a former ruler shall be exempted but in case such palace or a portion of a palace is letout , its income shall not be exempted.

**ix. Income of a local authority [Section 10(20)]**

The following types of incomes in the hands of a local authority are exempt from tax

1. Income from house property,
2. Capital gains,
3. Income from other sources, or
4. From a trade or business carried on by it which accrues or arises from the supply of a commodity or service (not being water or electricity) within its jurisdictional area or from the supply of water or electricity within or outside its own jurisdictional area.

This means that the income of a local authority from trade or business of supply of a commodity or service (excluding water and electricity) outside its jurisdictional area will be taxable.

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This means that the income of a local authority from trade or business of supply of a commodity or service (excluding water and electricity) outside its jurisdictional area will be taxable.

**xiv. Income of scientific research association [Section 10(21)]**

Any income of an approved scientific research association and if the same income is applied solely for the purposes of that association, i.e., for carrying scientific research.

The approval given under this section shall be withdrawn in following cases if :

1. the scientific research association has not applied its income as per conditions prescribed
2. the scientific research association has not invested or deposited its funds as per conditions prescribed ;
3. the activities of the scientific research association are not genuine
4. the activities of the scientific research association are not being carried on in accordance with conditions subject to which such institution was approved.

**xv. Income of a News Agency [Section 10(22B)]**

In case there is any income of a news agency set up solely in India for collection and distribution of news and which is so notified in this behalf shall be fully exempted provided such income or accumulated income is used solely for

collection and distribution of news and not to be distributed in any manner amongst its members.

The approval given under this section shall be withdrawn if the news agency has not applied, accumulated or distributed its income in accordance with the prescribed conditions, the notification issued under this section shall be cancelled.

**xvi. Income of some Professional Institutions [Section 10(23A)]**

Any income other than income chargeable under the head ‘ income from house property’ or any income received for rendering any specific services or income by way of interest or dividends derived from its investments of an association or institution established in India having its object as the control, supervision, or encouragement of the profession of law, medicine, accountancy, engineering or architecture or such other profession as the Central Government may notify in the Official Gazette. The following conditions are to be satisfied before any exemption is allowed under this clause

1. The association or institution applies its income or accumulates it for application, solely to the objects for which it is established.
2. The institution or association is approved for the purpose by the Central Government.

The approval given under this section shall be withdrawn in following cases if

1. the such association or institution has not applied its income as per conditions prescribed
2. the activities of the association or institution are not being carried on in accordance with conditions subject to which such institution was approved.

**xvii. Exemption of Income Received by Regimental Fund [Section 23AA]**

Any income received by any person on behalf of any Regimental Fund or Non Public Fund established by the armed forces of India for the welfare of the past and present members of such forces or their dependents shall be exempted from tax.

**xviii. Income of a Fund set-up for the welfare of employees or their dependents [Section 10(23AAA)]**

Any income of such fund which is approved by Commissioner of Income-tax shall be fully exempted provided its income is applied wholly and exclusively for the objects for which it is established.

The CBDT has notified following purposes for which the fund is expected to help its members or their dependents—

1. Cash amount given to a member of the fund—
2. on superannuation, or
3. in the event of member's own illness or illness of his/her spouse or dependent children; or
4. to meet the cost of education of dependent children of members.
5. Cash amount given to the dependents of members in the event of death of such a member.

**xix. Income of a pension fund set up by LIC or other insurer [Section 10(23MB)]**

Any income of a fund set up by Life Insurance Corporation of India on or after 1.8.1996 under a pension scheme or by any other insurer shall be fully exempted if contribution to such fund is made by any person for

receiving pension from such fund which is approved by the Insurance Regulatory and Development Authority.

**xx. Income of Institutions established for development of Khadi and Village Industries [Section 10(23B)]**

The public charitable trusts and societies registered under the Societies Registration Act, 1860 will be entitled to claim exemption from Income-tax for the income derived by such institutions from the production, sale or marketing of Khadi or products of village industries. The exemption will not be allowed unless the institution applies its income or accumulates it for application solely for the development of Khadi or Village Industries. Only such institutions will qualify for exemption which are approved by Khadi or Village Industries Commission.

The approval given under this section shall be withdrawn in following cases if

1. such association or institution has not applied its income as per conditions prescribed
2. the activities of the association or institution are not being carried on in accordance with conditions subject to which such institution was approved.

**xxi Income of State Level Khadi and Village Industries Board [Section 10(23BB)]**

Any income from an authority (whether known as the Khadi and Village Industries Board, or by any other name) established in a State by or under a State or Provincial Act for the development of Khadi or Village Industries in the State, shall be exempted from tax.

**xxii. Income of certain Authorities set up to manage Religious and Charitable Institutions [Section 10(23BBA)]**

Any income of any body or authority established, or appointed by or under any Central, State or Provincial Act which provides administration of any of the following institutions

1. Public, Religious or Charitable Trusts
2. Endowments (including Maths, Gurudwaras, Temples, Wakfs etc.)  
; or
3. a society for religious or charitable purposes registered under Societies Act 1860, shall be exempted from tax.

**xxiii. Income of European Economic Community [Section 10(23BBB)]**

Any income of European Economic community derived in India by way of interest, dividend or capital gain from investments made out of its funds under such scheme as the Central Govt. may notify is fully exempted.

**xxiv. Income of a SAARC Fund for regional projects [Section 10(23BBC)]**

Any income of a fund set up as SAARC Fund for Regional Projects set up by Colombo Declaration issued on 21<sup>st</sup>. Dec. 1991 by Heads of State or Government of the Member Countries of South Asian Association for Regional Co-operation shall be fully exempted.

**xxv. Any income of Insurance Regulatory and Development Authority [Section 10(23BBE)]**

Any income of Insurance Regulatory and Development Authority established under Insurance Regulatory and Development Authority Act 1999 shall be fully exempted.

**xxvi. Income of Prasar Bharti [Section 10(23BBH)] [Inserted by the Finance Act 2012, w.e.f. 2013-14]**

Any income of the Prasar Bharti (Broadcasting Corporation of India) established under section 3(1) of the Prasar Bharti (Broadcasting Corporation of India) Act, 1990, shall be exempt.

**xxvii. Any income received by a person on behalf of following Funds [Section 10(23C)]**

Any income received by any person on behalf of :

1. the Prime Minister's National Relief Fund ; or
2. the Prime Minister's Fund (Promotion of Folk Art) ; or
3. the Prime Minister's Aid to Student's Fund ; or
4. The National Foundation for Communal Harmony
5. Any educational institution which is
6. a non profit earning body and is wholly or substantially financed by the Government;
7. a non profit earning body whose aggregate annual receipts do not exceed the prescribed limits (to be notified) ; or
8. a non profit earning body other than those mentioned at (a) and (b) above but are approved by the prescribed authority.
9. any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or reception and treatment of persons during convalescence or of persons requiring medical attention and existing solely for philanthropic purposes and which:
10. is wholly or substantially financed by the Government ; or

11. whose aggregate annual receipts do not exceed the prescribed limits (to be notified); or
12. other than those mentioned a) and (b) above but is approved by the prescribed authority.
13. any other fund established for charitable purposes which may be notified by Central Government ; or
14. any trust or institution set up wholly for religious purposes or purpose which may be notified by the Central Government.

The above exemption shall not be available for the profits and gains of any business which is carried on, on behalf of or by any fund or institution referred in points (iv) and (v) above or to the profits or gains of any business undertaking held under trust for the purposes of any fund or institution referred in points (iv) and (v) above. This amendment has come into effect from assessment year 1984-85.

In case annual receipts of such an institution exceeds ₹ 1 crore in a previous year, it has to file an application upto 30th September in the succeeding financial year.

Under Section 10(23C) income of institutions specified above shall be exempt from income tax. In certain cases, approvals are required to be taken from prescribed authority in the prescribed manner to become eligible for claiming exemption.

**xxviii. Income of Mutual Fund [Section 10(23D)]**

Any income of such Mutual Fund set up by other public sector bank or a public financial institution or any fund authorised by Securities & Exchange Board of India or Reserve Bank of India and subject to such conditions as the Central Govt. may, by notification in the Official Gazette, specify in this behalf.

‘Other Public Sector Banks’ means the State Bank of India, all its subsidiary banks and all other’ nationalised banks. The expression ‘public financial institution’ shall have the meaning assigned to it in Section 4A of the Companies Act, 1956.

**xxix. Exemption of income of a securitisation trust [Section 10(23DA)] [w.e.f. A.Y. 2014-15]**

Any income of a securitisation trust from the activity of securitisation shall be exempt.

**xxx. Income of Investor Protection Fund [Section 10(23EA)]**

Any income received by an Investor Protection Fund by way of contributions received from recognised stock exchanges and the members thereof shall be fully exempted.

From the assessment year 2007-08 similar exemption has been extended to Investor Protection Fund set up by Commodity Exchanges also.

**xxxi. Income of the Credit Guarantee Trust for Small Industries [Section 10(23EB)]**

Such income shall be fully exempted for a period of 5 assessment years commencing with the assessment year 2002-03 to 2006-07.

**xxxii. Exemption of income of investor protection fund of depository [Section 10(23ED)] [w.e.f. A.Y. 2014-15]**

Any income, by way of contribution received from a depository, of such Investor Protection Fund set up in accordance with the regulations made under SEBI Act, 1992 and the Depositories Act, 1996 by a depository, as the Central Government may specify, by notification in the Official Gazette.

**xxxiii. Exemption for Certain Incomes of a Venture Capital Company or Venture Capital Fund from Certain Specified Business or Industries [Section 10 (23FB)]**

As per this amendment, the exemption will now be available only in respect of income of a Venture Capital Company or Venture Capital Fund from investment in a venture capital undertaking engaged in certain specified businesses or industries.

New **definition of “Venture Capital Company”, “Venture Capital Fund” and “Venture Capital undertaking”** [Explanation 1 of section 10 (23FB)] [w.e.f *A.Y.* 20 13-14]

- 1. Meaning of Venture Capital Company.** A company which has been registered before 21-5-2012 under the SEBI Regulations, 1996 (Venture Capital Fund Regulation) or which has been registered as venture capital fund being a sub category of category 1 Alternative Investment Fund under the SEBI Regulation 2012 (Alternative Investment Fund Regulations). The Company has to satisfy the conditions mentioned in clause (a).
- 2. Meaning of Venture Capital fund.** A trust which has been registered before 21-5-2012 under the Venture Capital Fund Regulations or which has been registered as venture capital fund being a sub-category of category 1 Alternative Investment Fund under the Alternative Investment Funds Regulations. The trust has to satisfy the conditions mentioned in clause (b).
- 3. Meaning of venture Capital undertaking.** As defined under the Venture Capital Fund Regulation or under the Alternative Investment Funds Regulation.

**xxxiv. Income of Registered Trade Unions [Section 10(24)]**

The following incomes of registered trade unions are exempt from tax :

1. Income from house property.
2. Income from other sources.

The trade union must be a registered one and formed primarily for the purpose of regulating the relations between workmen and employer or between workmen and workmen. This benefit shall also be available to an association of registered trade unions.

**xxxv. Income of Provident and Superannuation Funds [Section 10(25)]**

- (i) Interest on securities which are held by or are the property of any provident fund to which Provident Funds Act, 1925 applies and any capital gains of the fund arising from the sale, exchange or transfer of such securities.
- (ii) Any income received by the trustees on behalf of a recognised provident fund.
- (iii) Any income received by the trustees on behalf of an approved superannuation fund.

**xxxvi. Income of Employee's State Insurance Fund [Section 10 (25A)]**

Income of such fund is fully exempted.

**xxxvii. Income of Schedule Tribe Members [Section 10(26) and 10(26A)]**

Certain types of incomes of the members of Scheduled Tribes living in tribal areas are exempt from tax. The Scheduled Tribes to which this exemption applies are defined in Clause (25) of Article 366 of the Constitution, residing in any areas specified in Part A or Part B of the table appended to paragraph

20 of the Sixth Schedule of the Constitution or in the State of Arunachal Pradesh, Manipur, Tripura, Mizoram and Nagaland or in the Ladakh region of the State of Jammu & Kashmir.

The exempted incomes are incomes which accrue or arise to him :

1. from any source in the area, State, or Union Territories aforesaid, or
2. by way of dividend.

This means that if a member of a Schedule Tribe sets up a business at any place other than mentioned above, profit from such business will be taxable.

**xxxviii. Income of Sikkimese individual [Section 10(26AAN)] (With retrospective effect from 1-4-1990)**

The following incomes which accrues or arises to a Sikkimese individual shall be exempt from income tax—

1. income from any source in the State of Sikkim; or
2. income by way of dividend or interest on securities.

This exemption will not be available to a Sikkimese woman who, on or after 1-4-2008 marries a non-Sikkimese individual.

**xxxix. Regulating the marketing of agricultural produce [Section 10(26AAB)]**

Any income of an agricultural produce market committee or board constituted under any law for the time being in force for the purpose of regulating the marketing of agricultural produce shall be exempted.

**xxxx. Income of a corporation set-up for promoting the interests of Scheduled Castes, Scheduled Tribes or Backward Classes [Section 10(26B)]**

Income of such corporation or body, institutions or associations which are wholly financed by govt. and which have been set-up to promote the interest of above mentioned communities shall be fully exempted.

**xxxxi. Income of a corporation set-up to protect the interests of Minorities [Section 10(26BB)]**

Income of such a corporation is fully exempted.

**xxxxii. Any income of a corporation for ex-servicemen [Section 10(26BBB)]**

Any income of a corporation established by a Central, State or provincial Act for the welfare and economic upliftment of ex-servicemen being the citizens of India shall be fully exempted.

“Ex-serviceman” means a person who has served in any rank, whether as combatant or noncombatant in the armed forces of the Union or armed forces of the Indian States before the commencement of Constitution (but excluding the Assam Rifles, Defence Security Corps, General Reserve Engineering Force, Lok Sahayak Sena, Jammu and Kashmir Militia and Territorial Army) for a continuous period of not less than six months after attestation and has been released, otherwise than by way of dismissal or discharge on account of misconduct or inefficiency, and in the case of a deceased or incapacitated ex-servicemen includes his wife, children, father, mother, minor brother, widowed daughter and widowed sister, fully dependent upon such ex-serviceman immediately before his death or incapacitation.

**xxxxiii. Income of cooperative society looking after the interests of Scheduled Castes or Scheduled Tribes or Both [Section 10(27)]**

Such income shall be fully exempted provided the membership of such society consists of only other cooperative societies formed for similar purposes and the finances of the society are provided by Government and such other societies.

**xxxxiv. Any income accruing or arising to Commodity Boards etc. [Section 10(29A)]**

Any income accruing to

1. the Coffee Board constituted under section 4 of the Coffee Act, 1942 (7 of 1942), in any previous year relevant to any assessment year commencing on or after the 1st day of April, 1962 or the previous year in which such Board was constituted, whichever is later
2. the Rubber Board constituted under sub-section (1) of section 4 of the Rubber Board Act, 1947 (24 of 1947), in any previous year relevant to any assessment year commencing on or after the 1st day of April, 1962 or the previous year in which such Board was constituted, whichever is later
3. the Tea Board established under section 4 of the Tea Act 1953 (29 of 1953), in any previous year relevant to any assessment year commencing on or after the 1st day of April, 1962 or the previous year in which such Board was constituted, whichever is later
4. the Tobacco Board constituted under the Tobacco Board Act, 1975 (4 of 1975), in any previous year relevant to any assessment year commencing on or after the 1st day of April, 1975 or the previous year in which such Board was constituted, whichever is later
5. the Marine Products Export Development Authority established under section 4 of the Marine Products Export Development Authority Act, 1972 (13 of 1972), in any previous year relevant to any assessment year commencing on or after the 1st day of April, 1972 or the previous year in which such Authority was constituted, whichever is later

6. the Agricultural and Processed Food Products Export Development Authority established under section 4 of the Agricultural and Processed Food Products Export Development Act, 1985 (2 of 1986), in any previous year relevant to any assessment year commencing on or after the 1st day of April, 1985 or the previous year in which such Authority was constituted, whichever is later
7. the Spices Board constituted under sub-section (1) of section 3 of the Spices Board Act, 1986 (10 of 1986), in any previous year relevant to any assessment year commencing on or after the 1st day of April, 1986 or the previous year in which such Board was constituted, whichever is later.
8. the Coir Board established under section 4 of the Coir Industry Act, 1953.

**xxxxv. Amount received as subsidy from or through the Tea Board [Section 10(30)]**

This exemption is available to assessee carrying on the business of growing and manufacturing tea in India. The subsidy received by such assessee from or through the Tea Board under any such scheme for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for tea cultivation (*inserted by Finance Act, 1984*) as the Central Government may notify in the Official Gazette is exempt. For getting this exemption, the assessee is required to furnish to Assessing Officer, along with his return of income a certificate from the Tea Board showing the amount of subsidy received by him during the previous year. The A.O. may allow the assessee such time as he thinks desirable and the assessee is required to submit the said certificate within the allowed time.

**xxxxvi. Amount received as subsidy from or through the concerned Board [Section 10(31)]**

Any amount received as subsidy from or through the concerned Board for replantation or replacement of Rubber, Coffee, cardamom plants or plants for growing of such other commodities or for any other scheme so notified shall be fully exempted.

**xxxxvii. Income of child clubbed u/s 64 (IA) [Section 10(32)]**

In case income of a minor child is clubbed with the income of his parent, the parent can claim exemption upto actual income of child clubbed or 1,500 whichever is less in respect of each minor child whose income is included.

**xxxxviii. Income from transfer of capital assets of UTI [Section 10(33)]**

Any income arising from the transfer of a capital asset, being a unit of the Unit Scheme, 1964 referred to in Schedule I to the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 and where the transfer of such asset takes place on or after the 1st day of April, 2002 shall be fully exempted.

**xxxxix. Income by way of dividend from Indian company [Section 10(34)]**

Any income by way of dividends referred to in Section 115-O

**xxxxx. Exemption of income to a shareholder on buyback of shares of unlisted company [Section 10 (34A) [w.e.f. A.Y. 2014-15]**

Any income arising to an assessee being a shareholder, on account of buyback of shares, (not being listed on a recognised stock exchange) by the company as referred to in section 115QA shall be exempt.

**xxxxxi. Income from units of UTI and other mutual funds [Section 10(35)]**

Any income by way of:

1. income received in respect of the units of a Mutual Fund specified under clause (23D); or
2. income received in respect of the units from the Administrator of the specified undertaking; or
3. income received in respect of units from the specified company; shall be fully exempted in the hands of the recipient of such income.

This clause shall not apply to any income arising from transfer of units of the Administrator of the specified undertaking or of the specified company or of a mutual fund, as the case may be.

**xxxxxii. Exemption of income from securitization trust [Section 10(35A)] [w.e.f A.Y. 2014-15]**

Any income received by any person being an investor of the Securitisation Trust from such a trust, by way of distributed income referred to in section 11 5TA shall be exempt.

**xxxxxiii. Income from sale of shares in certain cases [Section 10(36)]**

Any income arising from the transfer of a long-term capital asset, being an eligible equity share.. in a company purchased on or after the 1st day of March, 2003 and before the 1st day of March 2004 and held for a period of twelve months or more.

For the purposes of this clause, “eligible equity shares” means :

1. any equity share in a company being a constituent of BSE-500 Index of the Stock Exchange. Mumbai as on the 1st of March, 2003 and the

transactions of purchase and sale of such equity share are entered into on a recognized stock exchange in India

- (ii) any equity share in a company allotted through a public issue on or after the 1st day of March, 2003 and listed in a recognized stock exchange in India before the 1st day of March, 2004 and the transaction of sale of such share is entered into on a recognized stock exchange in India.

**xxxxxiv. Capital Gain on compulsory acquisition of urban Agricultural Land [Section 10(37)]**

In the case of an assessee, being an individual or a Hindu individual family, any income chargeable under the head "Capital gain" arising from the transfer of agricultural land, shall be exempted, where :

1. Such land is situated in any area referred to in, item (a) or item (b) of sub-clause (iii) of clause (14) of Section 2
2. Such land, during the period of two years immediately preceding the date of transfer, was being used for agricultural purposes by such Hindu undivided family or individual, or a parent of his
3. Such transfer is by way of compulsory acquisition under any law, or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India
4. Such income has arisen from the compensation or consideration for such transfer received by such assessee on or after the 1st day of April, 2004.

It may be noted in this connection that exemption is available only if compulsory acquisition has taken place on or after 1-4-2004. Exemption is also available if acquisition has taken place before 1-4-2004 but compensation has been received on or after 1-4-2004.

For the purposes of this clause, the expression, compensation or consideration” includes the compensation or consideration enhanced or further enhanced by any court, tribunal or other authority.

**xxxxxv. Long Term Capital Gain on transfer of shares and securities covered under Security Transaction Tax (STT) [Section 10(38)]**

Any income arising from the transfer of a long-term capital asset, being securities, i.e. shares of a company or units of an equity oriented fund and the transaction of sale of such securities is entered into in a recognised stock exchange in India on or after 1-10-2004 shall be fully exempted.

But the income by way of long-term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 11 5JB.

**xxxxxvi. Income from international Sporting event [Section 10(39)]**

Any specified income (which is from such international event and which is notified by the Central Govt.) of specified persons from any international event held in India shall be fully exempted if

1. such event is approved by the international body regulating the international sport relating to such event
2. it has participation by more than two countries ; and
3. is notified by the Central Govt. in this regard.

**xxxxxvii. Income received as grant by a subsidiary company [Section 10(40)]**

Any income of a subsidiary company received as grant or otherwise from its holding company which is engaged in the business of generation, transmission or distribution of power if such amount is received as for settlement of dues in connection with revival of existing business of power generation.

**xxxxxviii. Income from transfer of asset of an undertaking engaged in the business of generation, transmission or distribution of power [Section 10(41)]**

Income from transfer of capital asset of an undertaking engaged in the business of generation, transmission or distribution of power where such transfer takes place on or before 31.3.2006 and transfer is made to the Indian company as notified u/s 801A.

**xxxxxix. Income of a body or authority set up by two countries [Section 10(42)]**

Any specified income arising to a body or authority which—

1. has been established or constituted or appointed under a treaty or an agreement entered into by the Central Government with two or more countries or a convention signed by the Central Government;
2. is established or constituted or appointed not for the purposes of profit;
3. is notified by the Central Government in the Official Gazette for the purposes of this clause shall be fully exempted.

**Explanation.** For the purposes of this clause “specified income” means the income, of the nature and to the extent, arising to the body or authority referred to in this clause, which the Central Government may notify in this behalf.

**xxxxxxx. Reverse Mortgage [Sec. 10(43)]**

Any amount received by an individual as a loan, either in lump-sum or in installment in a transaction of reverse mortgage referred in clause (xvi) of Section 47 shall be exempted.

**xxxxxxi. New Pension System Trust [Sec. 10(44)]**

Any income received by any person for, or on behalf of the New Pension System Trust established on 27th February, 2008 shall be exempted.

**xxxxxxii. Exemption of Allowance or perquisite to chairman/member of UPSC [Section 10 (45)]**

Any allowance or perquisite, as may be notified by the Central Government in the Official Gazette, in this behalf, paid to the chairman or a retired chairman or any other member or retired member of the Union Public Service Commission, shall be exempt.

**xxxxxxiii. Exemption of ‘specified income’ of certain bodies or authorities [Section 10(46)]**

Any specified income arising to a body or authority or Board or Trust or Commission which :

1. is constituted or established by or under a Central, State or Provincial Act, or has been constituted by the Central Government or a State Government with the object of regulating or administering an activity for the benefit of general public;
2. is not engaged in commercial activity; and
3. is specified by the Central Government by notification in the Official Gazette in this behalf, shall be exempt.

The Central Government has the power to notify the nature and extent of the income of the body or authority or Board or Trust or Commission which shall constitute the specified income.

**xxxxxxiv. Exemption of Income of notified ‘Infrastructure debt fund’ [Section 10(47)]**

Any income of notified ‘infrastructure debt fund’, which is set up in accordance with the guidelines as may be prescribed, shall be exempt from income-tax.

**xxxxxxv. Exemption of Income of a foreign company from sale of Crude Oil in India [Section 10 (48)]**

Any income of a foreign Co. received in India in Indian currency on account of sale of crude oil to any person in India shall be exempt if the following conditions are satisfied

1. Such Income is in pursuant to an agreement or an arrangement entered into by the Central Govt. or approved by the Central Govt.;
2. having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Govt. in this behalf; and
3. the foreign company is not engaged in any activity, other than receipt of such income, in India.

**xxxxxxvi. Exemption of income of National Financial Holdings Company [Section 10(49)] [w.e.f. A.Y. 2014-15]**

Any income of the National Financial Holdings Company, being a company set up by the Central Government, shall be exempt.

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**1.10 SUMMARY**

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In India Income tax is governed by the Income tax Act 1961. It was first came into force on 1-4-1962. Income tax Act is used for determination of taxable income, tax liability and also provides procedure for assessment, appeal, penalties and prosecutions. Every year Finance Act bring amendment to this Act. Income Tax Act Contain 298 sections and XIV Schedules.

Income Tax is charge on total income earned by every person during the relevant previous year. Before this Act, the Indian Income-tax Act, 1922 was in force. The procedural matters with regard to income-tax are governed by the Income-tax Rules, 1962, its earlier counterpart being the Income-tax Rules, 1922. One must understand the basic concept important for the charge of Income tax i.e assessment year, previous year, income, exempted income etc.

### 1.11 GLOSSARY

**Income:** No precise definition of the word 'Income' is available under the Income-tax Act, 1961. The definition of Income as given in Section 2(24) of the Act starts with the word includes therefore the list is inclusive not exhaustive.

**Assessee:** In common parlance every tax payer is an assessee. However, the word assessee has been defined in Section 2(7) of the Act according to which assessee means a person by whom any tax or any other sum of money (i.e. interest, penalty etc.) is payable under the Act.

**Person:** Income-tax is charged in respect of the total income of the previous year of every person. Hence, it is important to know the definition of the word person.

**Assessment year:** means the period of twelve months commencing on 1st April every year.

**Previous year:** Income earned in a year is taxable in the next year. The year in which income is earned is known as previous year.

**Computation of income:** Income tax is a charge on the assessee's income. Income Tax law lays down the provisions for computing the taxable income on which tax is to be charged.

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**1.12 SELF ASSESSMENT QUESTIONS**

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- 1. Write a short note on i) Assessment year ii) Previous year iii) Residential status**

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- 2. Define income under sec 2(24) of the Income Tax Act 1961.**

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- 3. DISTINGUISH BETWEEN**

- i. Capital Receipt and Revenue Receipt**
- ii. Capital expenses and Revenue Expenses**
- iii. Capital losses and Revenue Losses**

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- 4. Explain exempted incomes.**

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5. **‘Every assessee is a person, but every person need not be an assessee’.**  
**Critically examine the statement with reference to the relevant definitions under the provisions of the Income Tax Act, 1951.**

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6. **“Income tax is a tax on income and not a tax on every item of money received.” Explain this statement with reference to capital and revenue receipts.**

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7. **What are important points to be borne in mind while determining the residential status of an individual?**

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### **1.13 SUGGESTED READINGS**

1. Bare Act : Income Tax Act, 1961 & Income Tax Rules, 1962.
2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.
3. Sampath Iyengars : Law of Income Tax, 11th Edition; Bharat Law House Pvt. Ltd., T-1/95, Mangolpuri Industrial Area, Phase I, New Delhi-110 083.
4. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

**SALARY**

**STRUCTURE**

- 2.1 Introduction**
- 2.2 Objectives**
- 2.3 Provident fund**
- 2.4 Allowances**
- 2.5 Perquisites**
- 2.6 Profits in lieu salary**
- 2.7 Income from salary**
- 2.8 Summary**
- 2.9 Glossary**
- 2.10 Self assessment questions**
- 2.11 Suggested readings**

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## 2.1 INTRODUCTION

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The taxability of income of a person depends on the chargeability of such income under the Income tax Act 1961. The total income of an assessee (subject to statutory exemptions) is chargeable under Section 4(1). The scope of the total income, which varies with the residential status, is defined in Section 5.

Section 15 enumerates the heads of income under which the income of an assessee will fall. The rules for computing income and the permissible deductions under different heads of income, are dealt in different sections of the Act. All income received as salary under Employer – Employee relationship is taxed under this head. On due or receipt basis, whichever arises earlier. Employers must withhold tax compulsarily (subject to section 192), if income exceeds minimum exemption limit, as tax deducted at source (TDS), and provide their employees Form 16 which shows the total amount of tax deducted from his net income.

## 2.2 OBJECTIVES

- To enable the students with basic and practical understanding about the various components that form the part of total ‘Salary’ eligible for tax purpose
- To acquaint the students with the understanding of various deductions available out the gross salary
- To impart the practical knowledge about the computation of Income from Salary

### **Definition of word ‘ salary’ [ section 17 (1)]**

According to section 17 (1) salary includes the following amounts received by an employee from his employer, during the previous year

- (i) Wages

- (ii) Any annuity or pension (Family pension received by heirs of an employee is taxable under income from other sources)
- (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 participating in a recognized provident fund to the extent to which it is chargeable to tax under rule 6 of part A of 4<sup>th</sup> 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 4<sup>th</sup> schedule , of an employee participating in a recognized provident fund, to the extent to which it is chargeable to tax, under sub- rule (4) there, i.e., taxable portion of transferred balance from URPF to RPF
- (ix) The contribution made by the central government or any other employer in the previous year, to the account of an employee under a pension scheme referred to in section 80 CCD.

### **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 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 a covered under the

provisions of this act. Even the remuneration payable to an employee of a foreign covered under the provisions of this act. Even servant is an employee, but an agent may or may not be employee. Govt falls within this section. A detailing agent of a selling concern is its employee whereas the person holding an agency to sell the goods of such a concern will not be employee. The relationship of master and servant is the only test to establish the relationship of employer and employee. A director of a company, though holding an office, is not an employee unless it is so provided in the independent contract, or the articles of association of the company provide for such a relationship.

2. **Nature of employer:** An employer may be an individual i.e., sole proprietor, partnership firm, limited liability , partnership firm, HUF, company , local authority , AOP/BOI Or any other artificial judicial person.
3. **Salary from more than one employer:** Any amount of salary received or due from one or more than one employer/ source shall be taxable under this head. Such situation may arise when an employee is working with two employers simultaneously or has worked with one employer and later on serves with another employer after leaving services with first employer, salary from both the employers shall be taxable under this head.
4. **Salary from present, past or Prospective employer:** Salary received or due from present , past or future employer is also taxable under this head .
5. **Tax free salary:** Sometimes, the employer allows an employee to draw tax free salary e.g., the employer pays full salary to the employee and also pays tax on this directly to the department. The employee's assessment is to be made not on the amount of salary he is drawing but on gross amount i.e, salary drawn plus the tax paid by the employer.
6. **Receipts from persons other than employer:** Perquisites or benefits or any other remuneration received from persons other than the employer would

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

7. **Salary or pension received by UNO employees:** It is fully exempted as per circular NO. 293 dt. 10-2-81.
8. **Salary received by a teacher/ researcher from a SAARC member state:** Exempted up to 2 years.
9. **Salary as partner:** Any Salary, commission or remuneration received by a working partner from a firm/ LLP shall not be taxable under the head 'salaries'. It is taxable under the head profits and gains in the hands of partner to the extent deduction is allowed to him.
10. **Payment made after cessation of employment:** Payment made by an employer to his employee after the cessation of his employment is also taxable under the head salaries. It is taxable under this head because it represents remuneration for services rendered in the past.

### 2.3 PROVIDENT FUND

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. He will get payment out of this fund at the time of retirement and at some

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other important occasions. If the employee dies, his heirs will get the full payment.

Provident funds are of four kinds:

1. Statutory provident fund or the fund to which the act of 1925 applies (S.P.F)
2. Recognised provident fund ( RPF)

3. Unrecognised provident fund (URPF)
4. Public provident fund (PPF)

#### Treatment of provident funds

Under Income Tax Act, 1961, contribution by employer and employee to the provident fund account enjoys certain tax benefits and some are taxable as well. Provident Funds provides a compulsory contribution for the future of an employee after his retirement or for his dependents in case of his early death. In such fund employee and employer contribute equally. There are many provident funds in which the contribution can be made and the taxability of the same depends upon the type of

particulars	Fund governed by PF Act, 1925 for govt. and semi- govt. employees	Recognised provident fund for Private sector	Unrecognised URPF for private sector
Employees own contribution	Fully qualifies for deduction u/s 80 C	Fully qualifies for deduction u/s 80 C	Does not qualify for deduction u/s 80 C
Employer's contribution	Fully exempted	It is deemed to be received by employee. Excess of employer's contribution to RPF over 12 % of salary is taxable.	Ignore for the time being.
Interest credited to accumulated balance	Fully exempted	Exempted upto rate prescribed by the government. Excess over this amount is taxable i.e., 9.5 %	Ignore for the time being
Refund/Transferred balance of URPF to RPF	Fully exempted	Exempted in all cases except when employee leaves service of his own accord before completion of 5 years continuous service. In such case the amount which has not been charged to tax is added in salary	In case of refund taxable portion is added in salary income of the year [ entitled to relief u/s 89 (1)]. In case transferred balance amount which would have been taxable had the fund been RPF is added in salary.

provident fund in which the contribution is made. Basically, there are three types of Provident Fund Schemes provided by the employer, namely Statutory provident fund, Recognised provident fund and Unrecognised provident fund. However, an employee may also contribute to the Public Provident Fund scheme. Contribution is made in the Provident Fund for the employee's welfare by the employee and the employer. The deduction is available under section 80C.

Provident fund is a kind of security fund in which the employees contribute a part of their salary and the employer also contributes on behalf of their employees. Section 10(11) and 10(12) of the Income Tax Act defines the exemption on the amount added to the provident fund. Additionally, the amount allowed as a deduction on contributing to the provident fund is dealt in section 80C of the Income Tax Act.

- a) **Statutory provident fund-** Statutory Provident Fund (SPF) is meant for employees of Government or Universities or Educational Institutes affiliated to University. This fund is set up under the provisions of the Provident Fund Act, 1925. This fund is maintained by Government and Semi-Government organizations, local authorities, railways universities and recognized educational institutions. 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 statutory provident fund 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 statutory provident fund, the amount so received will not be included in employee's total income [Section 10(11)] being exempted income. The employee's own contribution will qualify for deduction u/s 80C.

Taxability as per the Income Tax Act, 1961:

- Employer's contribution to provident fund – Exempt
- Deduction under Section 80C – Available for employee's own contribution
- Interest credited to provident fund – Exempt
- Payment at retirement or termination of service – Exempt

**b) Recognized Provident Fund** – Recognised Provident Fund (RPF) is recognised by Commissioner of Income Tax under EPF and Miscellaneous Provision Act, 1952. According to this Act, any organisation, which employs 20 or more persons, is obligated to register under the Act and start a PF scheme for the employees in the organisation. As the name suggests, it is a fund to which the Commissioner of Income-tax has given the recognition as required under the Income-tax Act. Generally this fund is maintained by industrial undertakings, business houses, banks, etc. The employer's contribution over and above 12% of employee's salary, will be included in employee's salary income for tax purposes. The employee's contribution towards this fund will fully *qualify* for deduction u/s 80C. Interest on Provident Fund credit balance upto prescribed rate (9.5%) is exempted, but interest credited over and above such rate is deemed to be employee's salary income and is included in salary income of that previous year.

Taxability as per the Income Tax Act, 1961:

- Employer's contribution to provident fund – Exempt up to 12% of salary – excess is taxable
- Deduction under Section 80C – Available for employee's own contribution
- Interest credited to provident fund – Exempt up to notified rate (now 9.5%)
- Payment at retirement – Taxable except in following under mentioned circumstances –

The employee should have rendered continuous service with his employer for 5 years or more; or if not so, he should have been terminated due to ill health, due to discontinuation of employer's business or by reason beyond his control. If he has found another employment, the balance due to him should have been transferred to his account in the recognised provident fund of the new employer.

- c) **Unrecognized Provident Fund** - Unrecognized provident fund is the provident fund which is neither a statutory provident fund nor a recognised fund. This scheme is started by an employer which is not approved by the Commissioner of Income Tax. It is the provident fund which is not recognised 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 (if 'net salary' or 'salary after deduction of' is given) 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. When the unrecognised provident fund is recognised for the first time, the credit balance in the employee's unrecognised provident fund is transferred to the recognised 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.

Taxability as per the Income Tax Act, 1961:

- Employer's contribution to provident fund – Exempt from tax

- Deduction under Section 80C – Not Available
- Interest credited to provident fund – Exempt
- Payment at retirement – Employee’s own contribution is exempt but interest on his own contribution is taxable
- Payment at retirement – Employee’s own contribution is exempt but interest on his own contribution is taxable under the head “income from other sources”. Payment received towards the employer’s contribution and interest thereon is taxable under the head “Salaries”

Public Provident Fund (PPF) under Public Provident Fund Act, 1968 is another system of contributing to the provident fund. Self-employed people can also take part in this scheme. A minimum contributing limit of Rs. 500 per annum and a maximum of Rs. 150000 per annum are set.

**(d) Public Provident Fund.** So far all these funds were for the salaried people. On July 1, 1968 a new fund known as public provident fund 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 State Bank of India and its subsidiaries. The subscription can be between ₹ 500 and ₹ 1,00,000 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 ₹ 500 and the maximum ₹ 1,00,000. 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. Balances in the public provident fund are not liable to attachment by any court.

- (e) **Superannuation fund:** Superannuation Fund is a retirement benefit given to employees by the Company. Normally the Company has a link with agencies like LIC Superannuation Fund, where their contributions are paid. The Company pays 15% of basic wages as superannuation contribution. There is no contribution from the employee. Interest on contributions is credited to the members account. Normally the rate of interest is equivalent to the PF interest rate. On attaining the retirement age, the member is eligible to take 25% of the balance available in his/her account as a tax free benefit. The balance 75% is put in a annuity fund, and the agency (LIC) will pay the member a monthly/quarterly/periodic annuity returns depending on the option exercised by the member. This payment received regularly is taxable. In the case of resignation of the employee, the employee has the option to transfer his amount to the new employer. If the new employer does not have a Superannuation scheme, then the employee can withdraw the amount in the account, subject to deduction of tax and approval of IT department, or retain the amount in the Fund, till the superannuation age. Normally Companies do not extend the Superannuation benefits to all employees but only to a specific category of employees – like for example Level for example Level-1 of Managers onwards.

**Table 2.1:**

**Tax Treatment of Provident Fund**

1. Taxable Portion = Employer's contribution + Interest on this part. Interest on employee's own contribution is taxable under the head Income from Other Sources.

**2.4 ALLOWANCES [ SECTION 17 (3)]**

The term allowance has been derived from the word 'to allow'. The word 'Allowance' means "any amount or sum allowed regularly". These allowances are given to an employee to meet some specific type of loss or expenditure of the 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. An allowance is the financial benefit given to the employee by the employer over and above the regular salary. These benefits are provided to cover expenses which may be incurred to facilitate the discharge of service for example Conveyance Allowance is paid to foot expenses incurred for commuting to workplace. Some of these allowances are taxable under the head Salaries. A few of them again could be partly taxable and few others are non-taxable or fully exempt from taxes. These are divided into three categories on the basis of their tax treatment. These are:

#### **Tax Treatment of Allowances for Computing Salary Income**

	<b>Particulars</b>	<b>Fund governed by P.F. Act 1925(S.P.F.) (For Govt. or Semi Govt. Employees)</b>	<b>Recognised Provident Fund (R.P.F.) (For Private Sector)</b>	<b>Unrecognised P.F. (U.R.P.F.) (For Private Sector)</b>
1.	Employee's own contribution,	Fully qualifies for deduction u/s 80C	Fully qualifies for deduction u/s 80C	Does not qualify for deduction u/s 80C
2.	Employer's contribution	Fully exempted	It is deemed to be received by employee. Excess of Employer's contribution to R.P.F. over 12% of salary is taxable	Ignore for the time being.
3.	Interest credited to Accumulated Balance,	Fully exempted	Exempted upto rate prescribed by the Government. Excess over this amount is taxable ( <i>i.e.</i> 9.5%)	Ignore for the time being.
4.	Refund/Transferred Balance of U.R.P.F. to R.P.F.	Fully exempted	Exempted in all cases except when employee leaves service of his own accord before completion of 5 years' continuous service. In such case the amount which has not been charged to tax is added in salary	In case of refund taxable portion' is added in salary income of the year [Entitled to relief u/s 89(1)1. In case transferred balance amount which would have been taxable had the fund been RPF is added in salary

<i>A</i> <b>Fully Exempted</b>	<i>B</i> <b>Fully Taxable</b>	<i>C</i> <b>Partially Taxable</b>
1. Foreign Allowance only in case of Government employees posted outside India  2. House rent allowance given to judges of High Court and Supreme Court.  3. Sumptuary Allowance given to judges of High Court and Supreme Court	1. Dearness Allowance Additional Dearness allowance High Cost of living allowance  2. City Compensatory Allowance  3. Capital Compensatory Allowance  4. Lunch Allowance	1. House Rent Allowance  2. Entertainment Allowance for Govt. employees (see details)  3. Allowances covered u/s 10(14) <i>(i)</i> Helper Allowance <i>(ii)</i> Uniform Allowance <i>(iii)</i> Academic Allowance <i>(iv)</i> Conveyance Allowance

<p>4. Allowances from U.N.O</p> <p>5. Allowance to teacher or professor from SAARC member States</p> <p>6. Allowance to member of Union Public Service Commission</p>	<p>5. Tiffin Allowance</p> <p>6. Marriage Allowance</p> <p>7. Family Allowance</p> <p>8. Deputation Allowance</p> <p>9. Wardenship Allowance</p> <p>10. Non practicing Allowance</p> <p>11. Project Allowance</p> <p>12. Overtime Allowance</p> <p>13. Fixed Medical Allowance</p> <p>14. Entertainment Allowance for non Govt. employees</p> <p>15. Water and Electricity Allowance</p>	<p>(v) Travelling Allowance</p> <p>(vi) Any special allowance in the nature of Composite Hill compensatory Allowance or High Altitude Allowance or Uncongenial Climate Allowance or Snow Bound Area Allowance or Avalanche Allowance</p> <p>(vii) Any Special Compensatory Allowance in the nature of border area or remote area or difficult area or disturbed area Allowance</p> <p>(viii) Transport Allowance (ix) Tribal Area Allowance</p> <p>(x) Running Allowance given to employees of transport sector,</p> <p>(xi) Children Education Allowance</p>
	<p>16. Servant Allowance</p> <p>17. Holiday Trip Allowance</p>	<p>(xii) Hostel Expenditure Allowance</p> <p>(xiii) Compensatory Field Area Allowance</p> <p>(xiv) Compensatory Modified Field Area Allowance</p> <p>(xv) Special Allowance in the nature of counter insurgency allowance given to the members of armed forces operating in areas away from their permanent locations for a period of more than 30 days.</p>

### **Taxable Allowances:**

- 1. Dearness Allowance:** Dearness Allowance (DA) is an allowance paid to employees as a cost of living adjustment allowance paid to the employees to cope with inflation. DA paid to employees is fully taxable with salary. The IT Act mandates that tax liability for DA along with salary must be declared in the filed return.

**Sometimes , it is mentioned that:**

**D.A enters into pay for service benefits or**

**D.A enters into pay for retirement benefits or**

**D.A is given under the terms of employment or**

### **Dearness pay**

- 2. Entertainment Allowance:** Employees are allowed the lowest of the declared amount —one-fifth of basic salary, actual amount received as allowance or Rs. 5,000. This is an allowance provided to employees to reimburse the expenses incurred on the hospitality of customers. However, Government employees can claim exemption in the manner provided in section 16 (ii). All other employees have to pay tax on it.

**Under section 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 the 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 followings:

- (a)** Statutory limit Rs 5,000
- (b)** 1/5 th of basic salary only or
- (c)** Actual entertainment allowance received during the previous year.

3. **Overtime Allowance:** Employers may provide an overtime allowance to employees working over and above the regular work hours. This is called overtime and any allowance received for this is fully taxable.
4. **City Compensatory Allowance:** City Compensatory Allowance is paid to employees in an urban centre which may be highly expensive and to cope with the inflated living costs in the cities. This allowance is fully taxable.
5. **Interim Allowance:** When an employer gives any Interim Allowance in lieu of final allowance, this becomes fully taxable.
6. **Project Allowance:** When an employer provides an allowance to employees to meet project expenses, this is also fully taxable.
7. **Tiffin/Meals Allowance:** Sometimes employers may provide Tiffin/Meals Allowance to the employees. This is fully taxable.
8. **Cash Allowance:** When the employer provides a cash allowance like marriage allowance, bereavement allowance or holiday allowance, it becomes fully taxable.
9. **Non-Practicing Allowance:** When physicians are attached to Clinical Centers of the various Laboratories/Institutes, any non-practicing allowance paid to them become fully taxable.
10. **Warden Allowance:** When an employer pays an allowance to an employee working as a Warden i.e. Keeper in an educational Institute, the allowance received is fully taxable.
11. **Servant Allowance:** When an employer pays an employee to engage services of a servant, such an allowance is taxable.

## **Partly Taxable:**

**1. House Rent Allowance (HRA):** Sometimes the employer does not provide rent free accommodation but instead makes a 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 house rent allowance. Out of the total HRA received, an amount equal to the minimum of the following three items is exempted from tax u/s 10 (13A) read with rule 2A and balance, if any, will be added in the salary of the employee for tax purpose. Tax exemption under section 10 (13A) can be claimed on whichever amount is lower of the three:

- HRA as per actuals received by the employee
- Rent paid as per actuals less 10% of Basic Salary
- In Metros i.e Delhi, Mumbai, Chennai or Kolkata, as much as 50% of basic salary or else 40% of it if the accommodation is in a non-metro.

Any amount of House Rent Allowance received after claiming such deduction is taxable.

**Meaning of salary in case of HRA** = basic + DA( enters)/DP + Commission on turnover

**Cases when HRA is fully taxable:** If employee is living in his own house or

If employee is living in a house for which he is not paying any rent or If rent paid does not exceed 10 % of salary HRA fully exempted: In case HRA is received by judges of high court under high court judges ( condition of service) act, 1954 and supreme court judges under supreme court judges ( conditions of service ) act 1958 shall be exempted.

The exemption of HRA u/s 10 (13A) read with rule 2A shall be available even if employee is living in a rented houses at a place other than the place of his employment.

Mr. Hari is employed at Amritsar on a salary of Rs 30,000 p.m. The employer is paying HRA of Rs 8,000 p.m but the actual rent paid by him ( employee) is Rs 12,000 p.m. he is also getting 2 % commission on turnover achieved by him and turnover is Rs 50 lakh.compute his gross salary

Computation of gross salary of Mr. Hari

Salary @ 30,000 p.m		360,000
Commission @ 2 % of turnover		100,000
House rent allowance received	96,000	
Less :exempted u/s 10 (13A)	96,000	NIL
Taxable HRA		NIL
Gross salary		460,000

Calculation of HRA

- Actual HRA received		96,000
- Excess of Rent paid over 10 % of salary (144,000 – 46,000)		98,000
- 40 % of salary ( Amritsar)		184,000

**Fixed Medical Allowance:** This is an allowance paid by the employer when the employee or any of his family members fall sick for the cost incurred on their treatment. If any such reimbursement exceeds Rs.15,000 per year; the same is taxable.

**Special Allowance:** A special allowance paid to employees is covered under section 14(i) and does not fall within the purview of a perquisite. It is essentially for performance of a duty is partly taxable.

### **Non-Taxable or Exempted:**

Some of the allowances, usually paid to Government servants, judges and employees of UNO are not taxable. These are:

- **Allowances paid to Govt. servants abroad:** When servants of Government of India are paid an allowance while serving abroad, such income is fully exempt from taxes.
- **Sumptuary allowances:** Sumptuary allowances paid to judges of HC and SC are not taxed.
- **Allowance paid by UNO:** Allowances received by employees of UNO are fully exempt from tax.
- **Compensatory allowance paid to judges:** When a judge receives compensatory allowance, it is not taxable.

Here's a glance at allowances that are either taxable, partly taxable or non-taxable given under Income Tax Act., 1961:

**Table 2.2**

**ALLOWANCES AVAILABLE TO DIFFERENT CATEGORIES OF TAX PAYERS**

S. No	Sec.	Particulars	Limit of exemption	Exemption available to
<b>A. Under the head Salaries</b>				
1.	<a href="#">10(7)</a>	Any allowance or perquisite paid or allowed by Government to its employees posted outside India	Entire Amount	Individual-Salaried Employee (being a citizen of India)
2.	-	Allowances to Judges of High Court/Supreme Court	Exempt, subject to certain conditions.	Individual - Judges of High Court/Supreme Court
3.	-	Compensatory allowance received by a Judge under article 222(2) of the Constitution	Fully Exempt	Individual - Judges
4.	-	Salary and allowances received by a teacher /professor from SAARC member state (Subject to certain conditions).	Fully Exempt	Individual - Teacher from SAARC member State
5.	<a href="#">10(45)</a>	Following allowances and perquisites given to serving Chairman/Member of UPSC is exempt from tax: a) Value of rent free official residence b) Value of conveyance facilities including transport allowance c) Sumptuary allowance d) Leave travel concession	Fully Exempt	Individual - Chairman/Member of UPSC
6.	<a href="#">10(45)</a>	Allowances to Retired Chairman/Members of UPSC	Exempt subject to maximum of Rs. 14,000 per month for defraying the services of an orderly and for meeting	Individual - Retired Chairman/Member of UPSC

			expenses incurred towards secretarial assistant on contract basis.	
7.	-	Allowances paid by the UNO to its employees	Fully Exempt Individual - Government employee	Individual - Employees of UNO
8.	<a href="#">16(ii)</a>	Entertainment Allowance received by the Government employees (Fully taxable in case of other employees)	Least of the following is exempt from tax: a) Rs 5,000 b) 1/5th of salary (excluding any allowance, benefits or other perquisite) c) Actual entertainment allowance received	Individual - Government Employee
9.	<a href="#">10(13 A)</a>	House Rent Allowance (Sec. 10(13A) & Rule 2A)	Least of the following is exempt: a) Actual HRA Received b) 40% of Salary (50%, if house situated in Mumbai, Calcutta, Delhi or Madras)	Individual - Salaried employee

			<p>c) Rent paid minus 10% of salary</p> <p>* Salary= Basic + DA (if part of retirement benefit) + Turnover based Commission</p> <p>Note:</p> <p>i. Fully Taxable, if HRA is received by an employee who is living in his own house or if he does not pay any rent</p> <p>ii. It is mandatory for employee to report PAN of</p>	
			<p>the landlord to the employer if rent paid is more than Rs. 1,00,000 [Circular No. 08 / 2013 dated 10th October, 2013].</p>	
10	<a href="#">10(14)</a>	Children Education Allowance	Up to Rs. 100 per month per child up to a maximum of	Individual Salaried employee -

			2 children is exempt	
11	<a href="#">10(14)</a>	Hostel Expenditure Allowance	Up to Rs. 300 per month per child up to a maximum of 2 children is exempt	Individual Salaried employee -
12	<a href="#">10(14)</a>	Transport Allowance is granted to an employee to meet expenditure on commuting between place of residence and place of duty  With effect from AY 2019-20, the exemption regarding Transport Allowance has been discontinued for normal employees.	(Rs. 3,200 per month for blind, deaf, dumb and handicapped employees) is exempt	Individual Salaried employee -
13	<a href="#">Sec. 10(14)</a>	Allowance granted to an employee working in any transport business to meet his personal expenditure during his duty performed in the course of running of such transport from one place to another place provided employee is not in receipt of daily allowance.	Amount of exemption shall be lower of following: a) 70% of such allowance; or b) Rs. 10,000 per month.	Individual Salaried employee -
14	<a href="#">10(14)</a>	Conveyance Allowance granted to meet the expenditure on conveyance in performance of duties of an office	Exempt to the extent of expenditure incurred for official purposes	Individual Salaried employee -
15	<a href="#">10(14)</a>	Any Allowance to meet the cost of travel on tour or on transfer	Exempt to the extent of expenditure incurred for official purposes	Individual Salaried employee -
16	<a href="#">10(14)</a>	Daily Allowance to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty	Exempt to the extent of expenditure	Individual Salaried employee -

			incurred for official purposes		
17	<a href="#">10(14)</a> )	Helper/Assistant Allowance	Exempt to the extent of expenditure incurred for official purposes	Individual Salaried employee	-
1.	<a href="#">10(14)</a> )	Research Allowance granted for encouraging the academic research and other professional pursuits	Exempt to the extent of expenditure incurred for official purposes	Individual Salaried employee	-
2.	<a href="#">10(14)</a> )	Uniform Allowance	Exempt to the extent of expenditure incurred for official purposes	Individual Salaried employee	-
3.	<a href="#">Sec. 10(14)</a> )	Special compensatory Allowance (Hilly Areas) (Subject to certain conditions and locations)	Amount exempt from tax varies from Rs. 300 per month to Rs. 7,000 per month.	Individual Salaried employee	-
4.	<a href="#">Sec. 10(14)</a> ) read with Rule 2BB	Border area allowance Remote Locality or allowance or Disturbed Area allowance or Difficult Area Allowance (Subject to certain conditions and locations)	Amount exempt from tax varies from Rs. 200 per month to Rs. 1,300 per month.	Individual Salaried employee	-
5.	<a href="#">Sec. 10(14)</a> )	Tribal area allowance in (a) Madhya Pradesh (b) Tamil Nadu (c) Uttar Pradesh (d) Karnataka (e) Tripura (f) Assam (g) West Bengal (h) Bihar (i) Orissa	Up to Rs. 200 per month	Individual Salaried employee	-

6.	<a href="#">Sec. 10(14)</a>	Compensatory Field Area Allowance. If this exemption is taken, employee cannot claim any exemption in respect of border area allowance (Subject to certain conditions and locations)	Up to Rs. 2,600 per month	Individual Salaried employee	-
7.	<a href="#">Sec. 10(14)</a>	Compensatory Modified Area Allowance. If this exemption is taken, employee cannot claim any exemption in respect of border area allowance (Subject to certain conditions and locations)	Up to Rs. 1,000 per month	Individual Salaried employee	-
8.	<a href="#">Sec. 10(14)</a>	Counter Insurgency Allowance if this exemption is taken, employee cannot claim any exemption in respect of border area allowance (Subject to certain conditions and locations)	Up to Rs. 3,900 per month	Individual Members of Armed Forces	-
9.	<a href="#">Sec. 10(14)</a>	Underground Allowance is granted to employees working in uncongenial, unnatural climate in underground mines	Up to Rs. 800 per month	Individual Salaried employee	-
10.	<a href="#">Sec. 10(14)</a>	High Altitude Allowance is granted to armed forces operating in high altitude areas (Subject to certain conditions and locations)	a) Up to Rs. 1,060 per month (for altitude of 9,000 to 15,000 feet) b) Up to Rs. 1,600 per month (for altitude above 15,000 feet)	Individual Members of Armed Forces	-
11.	<a href="#">Sec. 10(14)</a>	Highly active field area allowance is granted to members of armed forces (Subject to certain conditions and locations)	Up to Rs. 4,200 per month	Individual Members of Armed Forces	-
12.	<a href="#">Sec. 10(14)</a>	Island Duty Allowance is granted to members of armed forces in Andaman and Nicobar and Lakshadweep group of Island (Subject to certain conditions and locations)	Up to Rs. 3,250 per month	Individual Members of Armed Forces	-
13.	-	City Compensatory Allowance	Fully Taxable	Individual Salaried employee	-
14.	-	Fixed Medical Allowance	Fully Taxable	Individual Salaried employee	-
15.	-	Tiffin/Lunch/Dinner/Refreshment Allowance	Fully Taxable	Individual Salaried employee	-

16	-	Servant Allowance	Fully Taxable	Individual Salaried employee	-
17	-	Dearness Allowance	Fully Taxable	Individual Salaried employee	-
18	-	Project Allowance	Fully Taxable	Individual Salaried employee	-
19	-	Overtime Allowance	Fully Taxable	Individual Salaried employee	-
20	-	Telephone Allowance	Fully Taxable	Individual Salaried employee	-
21	-	Holiday Allowance	Fully Taxable	Individual Salaried employee	-
22	-	Any Other Cash Allowance	Fully Taxable	Individual Salaried employee	-

**B. Under the head Income from house property**

1.	First proviso to <u>section 23(1)</u>	Municipal tax levied by local authority and borne by owner in respect of house property	Amount actually paid during the relevant previous year	All assessee
2.	<u>24(a)</u>	Standard Deduction	30% of the Annual Value (Gross Annual Value- Municipal Taxes)	All assessee
3.	<u>24(b)</u>	Interest incurred on borrowed capital	Interest on borrowed capital is allowed as deduction from income from house property as under: a) Up to Rs. 2,00,000 (if amount is borrowed for construction/acquisition of self-occupied house property on or after 01-04-1999), subject to certain other conditions b) Up to Rs. 30,000 (if amount is borrowed for reconstruction, repair or renewals of self-occupied house property) c) Actual amount of interest paid or	All assessee

			payable during the year (in case of let-out property) d) Pre-construction period interest is allowed in 5 annual equal installments (Subject to certain conditions)	
4.	<u>Section 25A</u>	Standard Deduction from arrears of rent or unrealized rent received subsequently	30% of arrears of rent or unrealized rent.	All assessee

### C. Under the head Profits and gains from business or profession

1.	<u>32(1)</u>	Depreciation in respect of: i) Tangible assets (buildings, machinery, plant or furniture); ii) Intangible Assets (know-how, patents, copyrights, trademarks, licenses, franchises, or any other business or commercial rights of similar nature)	Depreciation shall be allowed at prescribed percentage on actual cost of an asset. However, if asset is acquired and put to use for less than 180 days during the previous year, the deduction shall be restricted to 50% of depreciation computed above.	Taxpayer engaged in business of generation or generation and distribution of power. Note: Taxpayer engaged in business of generation or generation and distribution of power have the option to claim depreciation either on straight line basis or written down value basis.
2.	<u>32(1)</u>	Depreciation in respect of: i) Tangible assets (buildings, machinery, plant or furniture); ii) Intangible Assets (know-how, patents, copyrights, trademarks, licenses, franchises, or any other business or commercial rights of similar nature)	Depreciation shall be allowed at prescribed percentage on written down value of each block of asset (as per WDV method). However, if asset is acquired and put to use for less than 180 days during the previous year, the deduction shall be restricted to 50% of depreciation computed above.	All assesseees

3.	<u>32(1)(ii a)</u>	Additional depreciation on new plant and machinery (other than ships, aircraft, office appliances, second hand plant or machinery, etc.) shall be allowed subject to certain conditions.	Additional depreciation to be allowed at 20 % of actual cost of new plant and machinery. However, if an asset is acquired and put to use for less than 180 days during the previous year, 50% of additional depreciation shall be allowed in year of acquisition and balance 50% would be allowed in the next year.	All taxpayers engaged in: a) manufacture or production of any article or thing; or b) generation or transmission or distribution of power (if taxpayer not claiming depreciation on basis of straight line method)
4.	Proviso to <u>Secti on 32(1)(ii a)</u>	Additional depreciation on new plant and machinery (other than ships, aircraft, vehicle, office appliances, second hand plant or machinery, etc.) shall be allowed subject to certain conditions.	Additional depreciation to be allowed at 35 % of actual cost of new plant and machinery. However, if an asset is acquired and put to use for less than one 180 days during the previous year, 50% of additional depreciation shall be allowed in year of acquisition and balance 50% in next year.	All taxpayers which set up an undertaking or enterprise for production or manufacture of any article or thing in any notified backward area in the state of Andhra Pradesh, Bihar, Telangana or West Bengal. <b>Note:</b> 1. Manufacturing unit should be set-up on or after April 1, 2015. 2. New plant and machinery should be acquired and installed on or after April 1, 2015 but before April 1, 2020.

5.	<u>32A</u> <u>C</u>	Deduction under <u>section 32AC</u> is available if actual cost of new plant and machinery acquired and installed by a manufacturing company after 31-3-2013 but before 1-4-2015 exceeds Rs. 25/100 Crores, as the case may be.(Subject to certain conditions)	15% of actual cost of new asset acquired and installed	Company engaged in business or manufacturing or production of any article or thing
6.	<u>32A</u> <u>D</u>	Investment allowance for investment in new plant and machinery (other than ships, aircraft, vehicle, office appliances, second hand plant or machinery, etc.) if manufacturing unit is set-up in notified backward area in the State of Andhra Pradesh, Bihar, Telangana or West Bengal (subject to certain conditions)	Investment allowance to be allowed at 15 % of actual cost of new plant and machinery in the year in which such asset is installed.	All taxpayers who acquire new plant and machinery for purpose of setting-up manufacturing unit in notified backward areas in the State of Andhra Pradesh, Bihar, Telangana or West Bengal <b>Note:</b> 1) New asset should be acquired and installed on or after April 1, 2015 but before April 1, 2020. 2) Manufacturing unit should be set-up on or after April 1, 2015. 3) Deduction shall be allowed under Section 32AD in addition to deduction under Section 32AC if assessee fulfils the specified conditions.

7.	<u>33A</u> <u>B</u>	Amount deposited in Tea/Coffee/Rubber Development Account by assessee engaged in business of growing and manufacturing tea/Coffee/Rubber in India	Deduction shall be lower of following: a) Amount deposited in account with National Bank for Agricultural and Rural Development (NABARD) or in Deposit Account of Tea Board, Coffee Board or Rubber Board in accordance with approved scheme; or b) 40% of profits from such business before making any deduction under section 33AB and before adjusting any brought forward loss. (Subject to certain conditions)	All assessee engaged in business of growing and manufacturing tea/Coffee/Rubber
8.	<u>33A</u> <u>BA</u>	Amount deposited in Special Account with SBI/Site Restoration Account by assessee carrying on business of prospecting for, or extraction or production of, petroleum or natural gas or both in India	Deduction shall be lower of following: a) Amount deposited in Special Account with SBI/Site Restoration Account; or b) 20% of profits from such business before making any deduction under section 33ABA and before adjusting any brought forward loss. (Subject to certain conditions)	All assessee engaged in business of prospecting for, or extraction or production of, petroleum or natural gas or both in India

9.	<u>35(1)(i)</u>	Revenue expenditure on scientific research pertaining to business of assessee is allowed as deduction (Subject to certain conditions).	Entire amount incurred on scientific research is allowed as deduction. Expenditure on scientific research within 3 years before commencement of business (in the nature of purchase of materials and salary of employees other than perquisite) is allowed as deduction in the year of commencement of business to the extent certified by prescribed authority.	All assessee
10.	<u>35(1)(ii)</u>	Contribution to approved research association, university, college or other institution to be used for scientific research shall be allowed as deduction (Subject to certain conditions)	175% of sum paid to such association, university, college, or other institution is allowed as deduction.  150% of sum paid to such association, university, college or other institution is allowed as deduction (applicable from AY 2018-19)  Note:- From the AY beginning on or after the 1 <sup>st</sup> day of April, 2021, the deduction shall be equal to the sum so paid.	All assessee

11	<u>35(1)(ii)a)</u>	Contribution to an approved company registered in India to be used for the purpose of scientific research is allowed as deduction (Subject to certain conditions)	125% of sum paid to the company is allowed as deduction Entire sum paid to the company is allowed as deduction (applicable from AY 2018-19)	All assessee
12	<u>35(1)(ii)j)</u>	Contribution to approved research association, university, college or other institution with objects of undertaking statistical research or research in social sciences shall be allowed as deduction (Subject to certain conditions)	125% of sum paid to such association, university, college, or other institution is allowed as deduction Entire sum paid to such association, university, college or other institution is allowed as deduction (applicable from AY 2018-19)	All assessee
13	<u>35(2)</u>	Capital expenditure incurred during the year on scientific research relating to the business carried on by the assessee is allowed as deduction (Subject to certain conditions)	Entire capital expenditure incurred on scientific research is allowed as deduction. Capital expenditure incurred within 3 years before commencement of business is allowed as deduction in the year of commencement of business. <i>Note:</i> i. Capital expenditure excludes land and any interest in land; ii. No depreciation shall be allowed on such assets.	All assessee

14	<u>35(2AA)</u>	<p>Payment to a National Laboratory or University or an Indian Institute of Technology or a specified person is allowed as deduction.</p> <p>The payment should be made with the specified direction that the sum shall be used in a scientific research undertaken under an approved programme.</p>	<p>200% of payment is allowed as deduction (Subject to certain conditions).</p> <p>150% of payment is allowed as deduction (applicable from AY 2018-19)</p> <p>Note:- From the AY beginning on or after the 1<sup>st</sup> day of April, 2021, the deduction shall be equal to the sum so paid.</p>	All assessee
15	<u>35(2AB)</u>	<p>Any expenditure incurred by a company on scientific research (including capital expenditure other than on land and building) on in-house scientific research and development facilities as approved by the prescribed authorities shall be allowed as deduction (Subject to certain conditions).</p> <p>Expenditure on scientific research in relation to Drug and Pharmaceuticals shall include expenses incurred on clinical trials, obtaining approvals from authorities and for filing an application for patent.</p>	<p>200% of expenditure so incurred shall be as deduction.</p> <p><b>150% of expenditure so incurred shall be allowed as deduction (applicable from AY 2018-19)</b></p> <p><b>Note:</b></p> <p>i. Deduction shall be allowed if company enters into an agreement with the prescribed authority for co-operation in such research and development and fulfils conditions with regard to maintenance of accounts and audit thereof and furnishing of reports in such manner as may be prescribed.</p> <p>ii. From the AY beginning on or after the 1<sup>st</sup> day of April, 2021, the deduction shall be equal to the expenditure so incurred.</p>	Company engaged in business of bio-technology or in any business of manufacturing or production of eligible articles or things

16	<u>35A</u> <u>D</u>	Deduction in respect of expenditure on specified businesses, as under: a) Setting up and operating a cold chain facility b) Setting up and operating a warehousing facility for storage of agricultural produce c) Building and operating, anywhere in India, a hospital with at least 100 beds for patients d) Developing and building a housing project under a notified scheme for affordable housing e) Production of fertilizer in India (Subject to certain conditions)	150% of capital expenditure incurred for the purpose of business is allowed as deduction provided the specified business has commenced its operation on or after 01-04-2012. 100% of capital expenditure will be allowed to be deducted from the assessment year 2018-19 onwards <i>Note:</i> If such specified businesses commence operations on or before 31-03-2012 but after prescribed dates, deduction shall be limited to 100% of capital expenditure.	All assessee
17	<u>35A</u> <u>D</u>	Deduction in respect of expenditure on specified businesses, as under: a) Laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network; b) Building and operating, anywhere in India, a hotel of two-star or above category; c) Developing and building a housing project under a scheme for slum redevelopment or rehabilitation d) Setting up and operating an inland container depot or a container freight station	100% of capital expenditure incurred for the purpose of business is allowed as deduction provided specified businesses commence operations on or after the prescribed dates.	All assessee <b>Note:</b> Such deduction is available to Indian company in case of following business, namely;- (i) Business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network (ii) Developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility.

		<p>e) Bee-keeping and production of honey and beeswax</p> <p>f) Setting up and operating a warehousing facility for storage of sugar</p> <p>g) Laying and operating a slurry pipeline for the transportation of iron ore</p> <p>h) Setting up and operating a semi-conductor wafer fabrication manufacturing unit</p> <p>i) Developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility</p> <p>(Subject to certain conditions)</p>		
18	<u>35C</u> <u>CC</u>	Expenditure (not being cost of land/building) incurred on notified agricultural extension project for the purpose of training, educating and guiding the farmers shall be allowed as deduction, provided the expenditure to be incurred is expected to be more than Rs. 25 lakhs (Subject to certain conditions).	150% of the expenditure (Subject to certain conditions) <i>Note:-</i> 100% deduction shall be allowed from the 1st day of April, 2021	All assessee
19	<u>35C</u> <u>CD</u>	Expenditure incurred by a company (not being expenditure in the nature of cost of any land or building) on any notified skill development project is allowed as deduction (Subject to certain conditions).	150% of the expenditure (Subject to certain conditions) <i>Note: (i)</i> No deduction shall be allowed to a company engaged in manufacturing alcoholic spirits or tobacco products. <i>(ii)</i> 100% deduction shall be allowed for the AY beginning on or after 1st day of April, 2021	Company engaged in manufacturing of any article or providing specified services

Thus, allowances are given in cash along with salary by the employer. Allowance is a fixed monetary amount paid by the employer to the employees for meeting particular expense, whether personal or for the performance of duties. Allowances are generally taxable and are included in the gross salary unless a specific exemption has been provided in respect of any such allowance. Specific exemption in respect of allowances are provided mostly under the two heads:

- House Rent Allowance
- Prescribed Special Allowances.

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## **2.5 PERQUISITIES [ SECTION 17 (2)]**

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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. 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.

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 perk 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.

“Perquisite” may be defined as any casual emolument or benefit attached to an office or position in addition to salary or wages. In essence, these are usually non-cash benefits given by an employer to employees in addition to cash salary or wages. However, they may include cases where the employer reimburses expenses or pays for obligations incurred by the employee. Perquisites are also referred to as fringe benefits. Perquisites are benefits received by a person as a result of his/her official position and are over and above the salary or wages. These fringe benefits or perquisites can be taxable or non-taxable depending upon their nature. A lot of benefits and perks which come in addition to an individual’s salary are grouped under fringe benefits or perks. These components are taxed separately from the employer’s account so as to maintain transparency and accountability.

Depending upon the tax that is levied on perquisites these can be classified into the following three heads.

- **Taxable Perquisites:**

Some of the perquisites that are taxable in nature are rent-free accommodation, supply of gas, water and electricity, professional tax of employee, reimbursement of medical expense, and salary of servant employed by employee. Taxable perquisites also include any other fringe benefit provided by employer to employee like free meals, gifts exceeding Rs.5000, club and gym facilities etc.

- **Exempted Perquisites:**

Non-taxable fringe benefits include travel allowance, computer or laptop provided by the company for official use, refreshment provided by employer during office hours, provision of medical aid, use of health club, sports club, telephone lines, interest free salary loan provided by employer to employees, contribution to provident fund by employers, free medical and recreational facilities and so on.

- **Perquisites taxable only by employees:**

This type of perquisites include car owned by company but used by employee, education facility for children, service of domestic servant etc.

Broadly, “perquisite” is defined in the section 17(2) of the Income-tax Act as including:

- 1) Value of rent-free or concessional rent accommodation provided by the employer.
- 2) Value of any benefit/amenity granted free or at concessional rate to specified employees etc.
- 3) Any sum paid by employer in respect of an obligation, which was actually payable by the assessee.
- 4) Any sum paid by the employer for assurance on life of the employee or to effect a contract for an annuity.
- 5) Value of any other fringe benefit as may be prescribed.

According to the Finance Act, 2005, perquisites are taxed by the government in case these perks are provided or are deemed to be provided to employees by employers. The rate at which perquisites are taxed is 30% of the value of fringe benefits.

The perquisite tax is paid by the employer who furnishes these fringe benefits to employees. It can be a company, a firm, an association of persons or body of individuals.

Some of the most popular perquisites provided by a major percentage of companies to their employees are accommodation, cars and stock options. Let us see how these perks are taxed and how is this tax calculated ?

### **Company provided Accommodation:**

A lot of employees are provided leased accommodation option by their employers. This cost of accommodation is taxable and is a perk offered by the company. The tax will however depend upon whether the place is rented, owned or leased by the employer.

The tax levied in the above listed cases is as depicted in the table below.

Type of Accommodation	Population of the city	Percentage of tax
Owned by employer	Greater than 25 lakhs	15%
	Between 10-25 lakhs	10%
	Below 10 lakhs	7%
Leased by the employer	Actual rental paid or 15% whichever is lower	NA
	Accommodation provided in a hotel or guest house for more than 15 days	24%

**C. Furnished Accommodation in a Hotel:** The value of perquisite shall be determined on the basis of lower of the following

1. 24% of salary paid or payable in respect of period during which the accommodation is provided; or
2. Actual charges paid or payable by the employer to such hotel, for the period during which such accommodation is provided as reduced by any rent actually paid or payable by the employee.

However, nothing in C shall be taxable if following two conditions are satisfied:

1. The hotel accommodation is provided for a total period not exceeding in aggregate 15 days in a previous year, and

- 2 Such accommodation is provided on an employee's transfer from one place to another place.

It may be clarified that while services provided as an integral part of the accommodation, need not be valued separately as perquisite, any other services over and above that for which the employer makes payment or reimburses the employee shall be valued as a perquisite as per the residual clause. In other words, composite tariff for accommodation will be valued as per the Rules and any other charges for other facilities provided by the hotel will be separately valued under the residual clause.

**D.** However, the value of any accommodation provided to an employee working at a mining site or an on-shore oil exploration site or a project execution site or a dam site or a power generation site or an off-shore site will not be treated as a perquisite if:

- i) such accommodation is located in a —remote area or
- ii) where it is not located in a —remote area , the accommodation is of a temporary nature having plinth area of not more than 800 square feet and should not be located within 8 kilometers of the local limits of any municipality or cantonment board.

A project execution site here means a site of project up to the stage of its commissioning. A “remote area” means an area located at least 40 kilometers away from a town having a population not exceeding 20,000 as per the latest published all-India census.

**Cars provided by Employer:**

The tax on this type of perquisite depends upon two factors. First is whether the car is owned or leased by the employer and second whether the car is being used only for official purposes or partly for personal purposes and partly for official use. In both the cases, the tax calculated will be different. The table below depicts the corresponding rate of taxation in the various cases that may arise.

Type of Car	Rate of tax
Small cars below 1.6 litres	Rs.1800 per month
Big cars above 1.6 litres	Rs.2400 per month

### **Stock options made available to Employees by Employer:**

Stocks or shares are the most common way of rewarding employees. Most companies offer stock options to employees. The fair market value less the amount recovered from employee is the amount of tax that is applicable on shares as perquisites. The difference between FMV and selling price of the share is the net capital gain in the hands of the employees and that is the amount that is taxable.

- III Personal attendants etc. [Rule 3(3)]:** The value of free service of all personal attendants including a sweeper, gardener and a watchman is to be taken at actual cost to the employer. Where the attendant is provided at the residence of the employee, full cost will be taxed as perquisite in the hands of the employee irrespective of the degree of personal service rendered to him. Any amount paid by the employee for such facilities or services shall be reduced from the above amount.
- IV Gas, electricity & water for household consumption [Rule 3(4)]:** The value of perquisite in the nature of gas, electricity and water shall be the amount paid by the employer to the agency supplying the gas, electric energy or water. Where the supply is made from the employer's own resources, the manufacturing cost per unit incurred by the employer would be taken for the valuation of perquisite. Any amount paid by the employee for such facilities or services shall be reduced from the perquisite value.
- V Free or concessional education [Rule 3(5)]:** Perquisite on account of free or concessional education for any member of the employee's household shall be determined as the sum equal to the amount of expenditure incurred by the employer in that behalf. However, where such educational institution itself is maintained and owned by the

employer or where such free educational facilities are provided in any institution by reason of his being in employment of that employer, the value of the perquisite to the employee shall be determined with reference to the cost of such education in a similar institution in or near the locality if the cost of such education or such benefit per child exceeds Rs.1000/- p.m. The value of perquisite shall be reduced by the amount, if any, paid or recovered from the employee.

**VI Carriage of Passenger Goods [Rule 3(6)]:** The value of any benefit or amenity resulting from the provision by an employer, who is engaged in the carriage of passengers or goods, to any employee or to any member of his household for personal or private journey free of cost or at concessional fare, in any conveyance owned, leased or made available by any other arrangement by such employer for the purpose of transport of passengers or goods shall be taken to be the value at which such benefit or amenity is offered by such employer to the public as reduced by the amount, if any, paid by or recovered from the employee for such benefit or amenity. This will not apply to the employees of any airline or the railways.

**VII Interest free or concessional loans [Rule 3(7)(i)]:** It is common practice, particularly in financial institutions, to provide interest free or concessional loans to employees or any member of his household. The value of perquisite arising from such loans would be the excess of interest payable at **prescribed interest rate** over interest, if any, actually paid by the employee or any member of his household. The **prescribed interest rate** would be **the rate charged per annum by the State Bank of India as on the 1<sup>st</sup> day of the relevant financial year in respect of loans of same type and for the same purpose advanced by it to the general public**. Perquisite value would be calculated on the basis of the maximum outstanding monthly balance method. For valuing perquisites under this rule, any other method of calculation and adjustment otherwise adopted

by the employer shall not be relevant. However, small loans up to Rs. 20,000/- in the aggregate are exempt.

Loans for medical treatment of diseases specified in Rule 3A are also exempt, provided the amount of loan for medical reimbursement is not reimbursed under any medical insurance scheme. Where any medical insurance reimbursement is received, the perquisite value at the prescribed rate shall be charged from the date of reimbursement on the amount reimbursed, but not repaid against the outstanding loan taken specifically for this purpose.

**VIII Perquisite on account of travelling, touring, accommodation and any other expenses paid for or reimbursed by the employer for any holiday availed [Rule 3(7)(ii)]:**

The value of perquisite on account of travelling, touring, accommodation and any other expenses paid for or reimbursed by the employer for any holiday availed of by the employee or any member of his household, other than leave travel concession (as per section 10(5) ), shall be the amount of the expenditure incurred by the employer in that behalf. However, any amount recovered from or paid by the employee shall be reduce from the perquisite value so determined.

Where such facility is maintained by the employer, and is not available uniformly to all employees, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public. If a holiday facility is maintained by the employer and is available uniformly to all employees, the value of such benefit would be exempt.

Where the employee is on official tour and the expenses are incurred in respect of any member of his household accompanying him, the amount of expenditure with respect to the member of the household shall be a perquisite.

**IX Value of Subsidized / Free food / non-alcoholic beverages provided by employer to an employee[Rule 3(7)(iii)]:**

Value of taxable perquisite is calculated as under:		
Expenditure incurred by the employer on the value of food / non-alcoholic beverages including paid vouchers which are not transferable and usable only at eating joints‘	XXX	
Less: Fixed value of a sum of Rs. 50/- per meal	XXX	
Less: Amount recovered from the employee	XXX	<u>XXX</u>
Balance amount is the taxable as perquisites on the value of food provided to the employees	XXX	
Note: Exemption is given in following situations		
1. Tea/snacks provided in working hours.		
2. Food & non-alcoholic beverages provided in working hours in remote area or in an offshore installation.		

**X Membership fees and Annual Fees [Rule 3(7)(v)]:** Any membership fees and annual fees incurred by the employee (or any member of his household), which is charged to a credit card (including any add-on card) provided by the employer, or otherwise, paid for or reimbursed by the employer is taxable on the following basis:

Amount of expenditure incurred by the employer	XXX	
Less : Expenditure on use for official purposes	XXX	
Less : Amount, if any, recovered from the employee	XXX	<u>XXX</u>
Amount taxable as perquisite	XXX	
However if the amount is incurred wholly and exclusively for official purposes it will be exempt if the following conditions are fulfilled		
i) Complete details of such expense, including date and nature of expenditure is maintained by the employer.		
ii) Employer gives a certificate that the same was incurred wholly and exclusively for official purpose.		

**XI Club Expenditure [Rule 3(7)(vi)]:**

Any annual or periodical fee for Club facility and any expenditure in a club by the employee (or any member of his household), which is paid or reimbursed by the employer is taxable on the following basis:

Amount of expenditure incurred by the employer		XXX
Less : Expenditure on use for official purposes	XXX	
Less : Amount, if any, recovered from the employee	XXX	<u>XXX</u>
Amount taxable as perquisite		XXX

However if the amount is incurred wholly and exclusively for official purposes it will be exempt if the following conditions are fulfilled

- i) Complete details of such expense, including date and nature of expenditure and its business expediency is maintained by the employer.
- ii) Employer gives a certificate that the same was incurred wholly and exclusively for official purpose.

Note: 1) Health club, sport facilities etc. provided uniformly to all classes of employee by the employer at the employer's premises and expenditure incurred on them are exempt.

- 2) The initial one-time deposits or fees for corporate or institutional membership, where benefit does not remain with a particular employee after cessation of employment are exempt. Initial fees / deposits, in such case, is not included.

**XII Use of assets [Rule 3(7)(vii)]:** It is common practice for a movable asset (other than those referred in other sub rules of rule 3) owned by the employer to be used by the employee or any member of his household. This perquisite is to be charged at the rate of 10% of the original cost of the asset as reduced by any charges recovered from the employee for

such use. However, the use of Computers and Laptops would not give rise to any perquisite.

- XIII Transfer of assets [Rule 3(7)(viii)]:** Often an employee or member of his household benefits from the transfer of movable asset (not being shares or securities) at no cost or at a cost less than its market value from the employer. The difference between the original cost of the movable asset (not being shares or securities) and the sum, if any, paid by the employee, shall be taken as the value of perquisite. In case of a movable asset, which has already been put to use, the original cost shall be reduced by a sum of 10% of such original cost for every completed year of use of the asset. Owing to a higher degree of obsolescence, in case of computers and electronic gadgets, however, the value of perquisite shall be worked out by reducing 50% of the actual cost by the reducing balance method for each completed year of use. Electronic gadgets in this case means data storage and handling devices like computer, digital diaries and printers. They do not include household appliance (i.e. white goods) like washing machines, microwave ovens, mixers, hot plates, ovens etc. Similarly, in case of cars, the value of perquisite shall be worked out by reducing 20% of its actual cost by the reducing balance method for each completed year of use.
- XIV Gifts [Rule 3(7)(iv)]:** The value of any gift or vouchers or token in lieu of which such gift may be received, given by the employer to the employee or member of his household, is taxable as perquisite. However gift, etc less than Rs. 5,000 in aggregate per annum would be exempt.
- XV Medical Reimbursement by the employer exceeding Rs. 15,000/- p.a.** u/s 17(2) is to be taken as perquisite. It is pertinent to mention that benefits specifically exempt u/s 10(13A), 10(5), 10(14), 17 etc. of the Act would continue to be exempt. These include benefits like house rent allowance; leave travel concession, travel expense/allowance on tour and transfer,

daily allowance to meet tour expenses as prescribed, medical facilities subject to conditions.

Perquisites are taxed as per their nature and the provision of the same by the employer. However, with the economy growing rapidly and globalization seeping in, most employers have gone global and are adapting to international ways of taking care of employees. Perquisites paid as part of perks is an important component for employees and has been segregated as a separate taxable component by the government of India.

**From the following information , explain the treatment of the following medical benefits received by Mr. X an employee having monthly salary of Rs 60,000**

- (1) Received Rs 500 p.m as medical allowance**
- (2) During the year, Mr. X Met with an accident and his employer made the following payments (a) directly paid to a private specialists doctor's hospital Rs 20,000 (b) reimbursement medical expenditure incurred by employee in an approved hospital Rs 50,000 for a non-notified disease**
- (3) Employee was referred to a specialist doctor in London and employer met the following expenses in this connection**
  - (i) Expenses on travelling of the employee and one attendant Rs 60,000**
  - (ii) Operation fees of the specialist doctor Rs 50,000**
  - (iii) Expenses on medicines and hospitalization Rs 80,000****Reserve bank of India permitted an expenditure of Rs 100,000**
- (4) During the year, employer also reimbursed the following expenses incurred on the medical treatment of members of employee's family.**
- (5) During the year employer got the medical t**

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## **2.6 PROFITS IN LIEU or IN ADDITION OF SALARY**

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Any payment received or due in addition to your salary or wages from your employer is called profit in lieu of salary.

### **Receipts treated as Profit in Lieu of Salary [ Section 17(3)]**

Following types of receipts are treated as profits in lieu of salary :

1. The amount of any compensation due to or received by an employee from his employer or former employer at or in connection with the termination of his employment.
2. Any amount of compensation due to or received by an employee from his employer or former employer at or in connection with the modification of the terms and conditions of contract of employment.
3. Any amount of payment due to or received by an employee from his or her employer or former employer except the following types of payment to the extent these payments are exempt u/s 10.
  - Amount of payment received as gratuity exempted u/s 10(10).
  - Amount of payment received as commuted pension exempted u/s 10(10A).
  - Amount of payment received as retirement compensation exempted u/s 10(10B).
  - Amount of payment of house rent allowance received and exempted u/s 10(13A).
  - Amount of payment received from an approved superannuation Fund u/s 10(13).
  - Amount of payment received from a recognized provided fund to the extent it is exempt u/s 10(12).
  - Amount of payment received from statutory provident fund or Public Provident Fund Section u/s 10(11).
4. Any amount of payment received by employee from unrecognized provident fund or any such other fund to the extent to which it does not consist of employee's own contribution and interest thereon.

5. Any amount of sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.
6. Any amount due or received whether in lump sum or otherwise by any employee from any person before his joining any employment with that person; or after cessation of his/her employment with that person

#### **Payment exempted u/s 10**

#### **Leave travel concession/ Assistance [ section 10 (5)]**

Through this provision employees are encouraged to travel anywhere in India alongwith their families and to help the employee the travel expenses are given by employer which are exempt u/s 10 (5). The other details of this exemption are as follows:

1. **If journey is performed by air:** Least of following two amounts shall be exempted (i) economy class air fare of the national carrier by the shortest route .(ii) actual amount spent by the employee on journey by air travel.
2. **If journey is performed by rail:** Least of the following two amounts shall be exempted. (i) air conditioned first class rail fare by the shortest route(ii) actual amount spent by the employee on journey by rail.
3. **If place of origin of journey and place of destination is connected by rail.** In case , place of origin of journey and place of destination of journey of employee is connected with rail but the employee uses any other mode of transportation , the amount of exemption allowed shall be least of the following 2 amounts (i) air conditioned first class rail fare by the shortest route. (ii) actual amount spent by the employee on that journey.
4. **If place of origin of journey and place of destination is not connected by rail:** (a) if a recognized public transport system is operating. Least of the following 2 amounts shall be exempted – (i) first class or deluxe

class fare by the shortest route. (ii) actual amount spent by the employee on that journey. (b) if a recognized public transport system does not exist. Least of the following 2 months shall be exempted- (i) air conditioned first class rail fare by the shortest route. (ii) actual amount spent by the employee on this journey.

**Perquisites and allowance 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 fully 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 from tax.

**Death cum retirement gratuity [ section 10 (10)]**

Gratuity refers to a lumpsum payment made by an employer to his employee at the time of leaving the job in appreciation of his long and loyal services. Earlier, it was a voluntary payment but now it has become a sort of compulsory payment for government employees, semi- government employees, and all other employees working in banks, universities, colleges, factories,etc.,

- I In this case, gratuity is received by employee on leaving job either due to voluntary retirement or due to statutory retirement on reaching the superannuation age. Gratuity so received by employee is taxable under the head ‘ salary’ after claiming exemption as provided under section 10 (10).
- II Gratuity can also be received by the legal heirs of an ex- employee in the event of death of such employee. In this case, gratuity received shall be taxable in the hands of legal heirs under the head ‘income from other sources’ . In this case also, an exemption will be granted as provided under section 10 (10)

**Government employee:** Any death cum retirement gratuity received by government employee is fully taxable. Meaning of government employee means employees of central government, state government, local authority, working in defence, statutory corporations.

**Non- Government employee:** Non Government employee receiving gratuity under payment of gratuity act, 1972 [ POGA]. Certain non- government employees have been covered under the payment of gratuity act, 1972 by the central government and thus non government employees are required to pay gratuity as per the provisions of gratuity act, 1972 . An employee who works in such organizations can be called as covered employee. Any gratuity received by such an employee shall be exempted to the extent of lest of the following 3 amounts:

- (1) 15 Days salary ( 7 days in case of employees working in seasonal factories) for each completed year of service or part thereof in excess of six months on the basis of monthly salary last drawn.
- (2) Notified limit Rs 20 lakh - ( Rs 10 lakh for those who retired prior to march 29, 2018)
- (3) Gratuity actually received by the employee and balance shall be taxable.

Taxable gratuity = gratuity received – exempted.

**Non Government employee receiving gratuity not covered under payment of gratuity act.** Least of the following 3 amounts shall be exempt:

- (1) ½ month salary for every completed year of service on the basis of average salary drawn during 10 months immediately preceding the month of retirement.
- (2) Maximum notified limit Rs 20 lakh
- (3) Gratuity actually received by the employee and balance shall be taxable.

Taxable gratuity = actual gratuity - exemption

### **Pension [ monthly and Commuted]**

**Tax treatment of uncommuted pension:** Uncommuted pension refers to the periodic/ regular pension ( generally monthly) received by an employee from ex- employer after retirement and until such an employee dies.

**Tax treatment:** Fully taxable whether the employee is a government employee or non- government employee.

**Tax treatment of commuted pension:** Commuted pension refers to lumpsum amount received by an employee from his employer in lieu of periodical pension. When an employee receives such lumpsum amount, it is called commutation of pension.

It is exempted for all types of government employees.

**Meaning of government employee.** It includes employees of central government, state government , local authority, corporation under central state or provincial act or under the civil pensions rules of the central government, public sector undertaking, judges of supreme court or high courts of India.

### **For non – government employees**

- 1 **if employees receives gratuity also:** This exemption amount shall be commuted value of one- third of pension which he is normally entitled to receive.
- 2 **if employee does not receive gratuity.** The exempted amount shall be commuted value of one- half of such pension.

### **Leave encashment [ section 10 (10AA)]**

As per the terms of employment, generally, an employee is granted certain period of leave on yearly basis. Such leave (s) may be casual leaves, medical

leaves and privileged leaves or earned leaves. Generally, an employee can accumulate his medical leaves and privileged leaves and can avail such leaves in subsequent years as per his necessity. However, in some cases, an employee can even encash his accumulated privileged/ earned leaves and can get salary for the said period of leave. Such receipt of salary by an employee from his employer in lieu of his accumulated leaves is called leave encashment.

Such encashment can be done by an employee either during the service or at the time of leaving job due to retirement or any other reason. However, in case of death of an employee, the salary for his / her accumulated leave is given to his/her legal heirs.

Leave encashment during service: Any encashment of leaves by an employee during continuance of service is fully taxable for all employees whether government employees or non-government employees. Such encashment may either be of current year leaves or of past accumulated leaves. It is taxable as salary income of the employee for the previous year in which amount is received by employee.

**Leave encashment on leaving job/ retirement :**

1. **For government employee:** Any payment received as leave encashment at the time of retirement or on leaving job otherwise shall be fully exempted u/s 10 (10 AA) (i)
2. **For non- government employee:** Any payment received as leave encashment at the time of retirement or on leaving job otherwise shall be exempt upto the least of following amounts u/s 10 (10AA) (ii)
  - (i) maximum 10 months salary on the basis of average salary drawn during 10 months immediately preceding his retirement/ leaving job otherwise.

- (ii) Salary for approved period of leave standing to his credit at the time of retirement/ leaving job otherwise.
- (iii) Maximum notified limit Rs 3 lakh as specified by the central government.
- (iv) Actual amount received as leave encashment and balance shall be taxable.

Taxable amount of leave encashment = amount of leave encashment received – exempted amount out of least of 4 limits.

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## **2.7 INCOME FROM SALARY**

### **(Gross Salary, Deductions from Gross Salary, Income from Salary)**

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Salary is the remuneration received by or accruing to an individual, periodically, for service rendered as a result of an express or implied contract. The actual receipt of salary in the previous year is not material as far as its taxability is concerned. The existence of employer-employee relationship is the sine-qua-non for taxing a particular receipt under the head “salaries.” For instance, the salary received by a partner from his partnership firm carrying on a business is not chargeable as “Salaries” but as “Profits & Gains from Business or Profession”. Similarly, salary received by a person as MP or MLA is taxable as “Income from other sources”, but if a person received salary as Minister of State/ Central Government, the same shall be charged to tax under the head “Salaries”. Pension received by an assessee from his former employer is taxable as “Salaries” whereas pension received on his death by members of his family (Family Pension) is taxed as “Income from other sources”.

For the purpose of Sections 15 and 16 of the Income Tax Act 1961 the term ‘salary’ includes :

- Wages
- Any annuity or pension

- Any gratuity
- Any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages.
- Any advance of salary
- Any payment received by an employee in respect of any period of leave not availed by him i.e., encashment of leave salary.
- The annual accretion to the recognized provident fund of an employee to the extent provided in the rules. This may take two forms.
  - a) Employer's contribution to Provident Fund.
  - b) Interest credited on the accumulated balance of recognized provident fund standing to the credit of the employee.
 

as per rules employer's contribution to the P F in excess of 12% of the salary of the employee and the interest credited to the PF accumulations in excess of 9.5% will be considered as salary.
- Amount of the transferred balance of recognized provident fund to the extent to which it is taxable.
- Tax-free salary: Sometimes the employer deducts the tax at source and pays net salary to the employee. In such cases the individual has to show the aggregate salary i.e., net salary plus tax paid in his gross total income.

#### **RULES REGARDING SALARY:**

**Relation between Payer and Payee:** The relation between payer and payee should be that of employer and employee. In other words for an income to be taxed under head salaries the relation between payer and payee should be of employer and employee. Employer may be an Individual, firm, AOP etc and an employee may be full time or part time employee. If the relation between payer

and payee is not that of employer and employee income received cannot be charged under head Salaries it would be charged under other heads.

**Salary and wages:** Income tax does not differentiate between salary and wages.

**Salary from more than one source:** If an Individual receives salary from more than one employer during same previous year, salary from each source is taxable under the head Salaries.

**Overtime payment:** Any over time payment received by an employee is added to Gross Salary.

**Basis of Charge:** As per section 15

- Any salary due from an employer, or former employer in the previous year, whether paid or not
  - Any salary paid or allowed to an employee in the previous year by or on behalf of an employer though not due or before it becomes due to him
- Hence salary is taxable on due or receipt basis whichever is earlier.

**Fee and Commission:** Any fee or commission paid by employer to his employee on Net profit or Turnover is added to Gross Salary.

**Grade system:** Under this system the normal annual increments to be given to the employee is already fixed. Annual increment is given on the same date on which employee joins the employment.

**Employer employee relation:** Income can be charged under head Salaries only if relation between receiver and giver of payment is of employee and employer. Employer may be individual, firm, company, AOP, BOI, Govt., etc.

- Income by way of **examinership fees received by a professor** from the same university in which he is employed would not be chargeable to tax under this head but must be taxed as Income from other sources under Section 56.
- Income by way of **remuneration received by a managing director** would be taxable as his **salary** income whereas the income received by him as **director's fees** in his capacity as director for attending the meetings of the Board would be assessable under the head Income from **other sources**.
- An official liquidator appointed by the Court or by the Central Government would also become an employee of the Central Government under Section 448 of the Companies Act, 1956 and consequently the remuneration due to him would also be assessable under the head Salaries.
- Remuneration received by a manager of a company even if he is wrongly designated as a director or by any other name would be chargeable to tax under this head regardless of the fact that the amount is payable to him monthly or is calculated at a certain percentage of the company's profits.
- Any money from his employer as part of the terms of employment for not carrying on any profession, such income must be taxed as salary income.
- Any salary, commission, bonus etc received by partner of a firm will be charged under head PGBP.
- Salary received by Member of Parliament is to be charged under head Other sources and not under head Salary.

### **Gross salary**

Gross Salary is the amount paid before deduction of taxes or other deductions and is inclusive of bonuses, over-time pay, holiday pay, and other differentials. Gross Salary is the whole amount calculated after adding all the benefits and allowances without deducting any tax.

So you calculated everything in lump sum then it is called as Gross Salary, it is aggregation of everything. Gross salary is the sum total of Basic pay + Dearness allowance + House Rent Allowance + transport allowance + special allowance + other allowance.

You can invest under the Section 80C to a maximum of Rs.1,50,000. Or if you are in a higher tax bracket, you can save Rs.45,000 in tax.

**Hence GROSS SALARY means :**

1. Basic Salary or Wages, Bonus, Pension, Gratuity (beyond exempted limit), Leave Salary or encashment, Advance Salary, Salary arrears, Fee or Commission, Remuneration for extra work, Ex-gratia, Award for excellence etc.
2. Allowances such as House Rent Allowance, Dearness Allowance, City Compensatory Allowance, Children's Education Allowance, Conveyance Allowance, Fixed Medical Allowance and any other Special Allowances.
3. Perquisites - viz., Rent Free Accommodation, Amount spent or paid by the Employer on behalf of the Employee in respect of Gas, Electricity, Water Charges, Children's School Fee, Club Fees, etc.
4. Benefit received in place of Salary which includes Retrenchment Compensation (Amount given to an employee when his services are no more required).
5. Pension received from former Employer is taxable as "Salaries". However, Family Pension is taxed as income from other sources and is eligible for deduction up to Rs.15,000 or 33.33% whichever is less u/s 57 (ii a).

**However Gross Salary does not include :**

- (1) Retirement Gratuity / Death Gratuity u/s 10(10)
- (2) Sumptuary Allowance

- (3) Medical treatment Reimbursement (with restrictions)
- (4) Leave Travel Concession
- (5) Uniform Allowance
- (6) Leave encashment at retirement u/s 10(10AA)
- (7) Free Meals / Refreshment provided during office hours.

### **DEDUCTIONS OUT OF GROSS SALARY**

#### **i) Entertainment Allowance [Section 16(ii)]:**

A deduction is also allowed under section 16(ii) in respect of any allowance in the nature of an entertainment allowance specifically granted by an employer to the assessee, who is in receipt of a salary from the Government, a sum equal to one-fifth of his salary(exclusive of any allowance, benefit or other perquisite) or five thousand rupees whichever is less. No deduction on account of entertainment allowance is available to non-government employees.

#### **ii) Tax on Employment [Section 16(iii)]:**

The tax on employment (Professional Tax) within the meaning of article 276(2) of the Constitution of India, leviable by or under any law, shall also be allowed as a deduction in computing the income under the head “Salaries”.

It may be clarified that “Standard Deduction” from gross salary income, which was being allowed up to financial year 2004-05 is not allowable from financial year 2005-06 onwards.

<b>Computing Taxable Salary</b>	
Salary	.....
Dearness allowance or Dearness pay	.....
Bonus	.....
Commission	.....
Pension	.....
Employer's contribution in excess 12% to R.P.F.	.....
Interest in excess of 9.5% on Recognised Provident Fund	.....
Taxable Allowances	.....
Taxable portion of partially exempted allowances	.....
Perquisites (after proper valuation)	.....
Taxable part of gratuity .	....
Taxable part of commutation of pension .....	
Lump-sum received from Unrecognised Provident Fund to the extent of Employer's contribution and interest on Provident fund	.....
Taxable part of Compensation received	.....
Gross Salary	.....
Less : (i) Entertainment Allowance	.....
(ii) Employment Tax/Professional Tax	.....
Taxable Salary	----

<b>Illustration 1:</b>
<b>Calculation of taxable house rent allowance :</b>
Mr. Ram is employed at Bombay. His basic Salary is Rs. 5,000 per month. He receives ` 5,000 p.a. as house rent allowance. Rent paid by him is Rs. 12,000 p.a. Find out the amount of taxable house rent allowance.

**Solution :**

As per Rule 2A, the least of the following is exempt from tax :

- (i) the actual house rent allowance;
- (ii) excess of rent paid over 10% of salary;
- (iii) where the accommodation is situated at Bombay, Delhi, Calcutta or Madras, one-half of the amount of salary due to the assessee for the relevant period;
- (iv) Where the accommodation is situated at any other place, two-fifth of the salary due to the assessee for the relevant period.

Accordingly, Mr. Ram would be entitled to the least of :

- (i) Rs. 5,000 or
- (ii) Rs 6,000 being excess of rent over 1/10th of salary; or
- (iii) Rs 30,000 (being one-half of the salary of the assessee). Rs. 5,000, being the least, would not be included in the total income of Mr. Ram. So the entire amount of HRA would be exempt from tax. Salary for this purpose includes basic salary as well as dearness allowance if the terms of employment so provide. It also includes commission based on a fixed percentage of turnover achieved by an employee as per terms of contract of employment but excludes all other allowances and perquisites and these are determined on due basis for the period during which rental accommodation is occupied by the employee in the previous year.

<b>Illustration 2</b>
<b>Valuation of rent free unfurnished accommodation :</b>
<b>Mr. Shyam, employed at Mumbai, receives the following from his employer during the previous year: Basic Salary Rs 60,000, Bonus Rs. 1,800, Entertainment allowance (taxable) Rs. 6,000, Electricity expenses Rs. 2,000, Professional tax paid by the employer Rs. 2,000,</b>
<b>Rent free house (owned by Employer): Fair rent 48,000, Salary of gardener Rs. 2,400, Garden Maintenance Rs. 1,200, Salary of watchman Rs. 1,800. Determine the value of taxable perquisites in respect of rent free house assuming (a) Mr. Shyam is a Government Officer and the fair rent as arrived at by the Government is Rs. 6,000 p.a (b) Mr. Shyam is a semi-Government employee, and (c) Mr. Shyam is employed by a private company.</b>

**Solution :**

- (a) If Mr. Shyam is a Government Officer : As per Rule 3(1) of Income-tax Rules, ' 6,000 p.a being the rent of the house as per Government rules, will be the taxable value of the perquisite.

- (b) If Mr. Shyam is a semi-Government employee : As per Rule 3(1) of the Income-tax Rules, the value of the perquisite in respect of rent free accommodation is taken at 15% of salary of the employee (as the house is owned by the Employer and provided in Mumbai). Salary = ₹ 67,800 (Rs 60,000 + 1,800 + 6,000) , 15% of salary = Rs 10,170 and Therefore, Rs 10,170 is taxable value of the perquisite. Further, the value of Electricity expenses and Professional Tax paid by the employer, being perquisites are not included in the salary for valuation of Rent Free House Accommodation.
- (c) If Mr. Shyam is employed in Private Company : The value of perquisite in this case shall also be Rs 10,170. Under the new rules there is no difference between the semi-Govt. and other employees.

### **Illustration 3**

**Mr. Ramamoorthy, an employee of M/s. Gopalkrishnan & Co. of Chennai receives during the previous year ended March 31, 2020 the following payments : Basic Salary Rs 40,000, Dearness allowance Rs 3,000, Leave Salary Rs 5,400, Professional tax paid by employer 1,000, Fair rent of the flat provided by employer Rs 6,000, Rent paid for furniture Rs 1,000, Rent recovered by employer Rs 3,000, Contribution to Statutory Provident Fund Rs 4,000, Employer's contribution to Statutory Provident Fund Rs 4,000. Compute his taxable income for the Assessment Year 2020-21©.**

Solution :

Computation of taxable income of Mr. Ramamoorthy for the Assessment Year 2020-21

	Rs
Basic Pay	40,000
Dearness allowance	3,000
Leave salary	5,400
Professional tax paid by employer	1,000
Perquisite for House :	
15% of salary ( ` 40,000 + 3,000 + 5,400)	7,260
Add: Furniture rent	1,000
Less: Rent recovered	(-) 3,000
	54,660
Less: Professional tax u/s 16	- 1,000
Gross Total Income	53,660
Less: Tax deduction under Section 80C	-4,000
Tax on total income	49,660
Total tax payable	NIL
Note: Assumed that dearness allowance forms part of the salary for the purpose of computation of superannuation or retirement benefits.	

#### Illustration 4

**For the financial year 2019-20, 'A', a Central Government Officer receives salary of Rs 77,000 (including dearness allowance of Rs 42,000) and entertainment allowance of Rs 18,000. His contribution to provident fund during this period is Rs 7,200. In addition, he has purchased National Savings Certificates (VIII Issue) for Rs 6,000. He has been provided with accommodation by the Government for which the rent determined is Rs 375 per month and this is recovered from A's salary. Compute A's tax liability for the assessment year 2020-21 assuming that he has no other income.**

Solution:		
Name of assessee : Mr. A, Assessment Year : 2016-17, Status : Resident/Individual		
Statement of assessable income		
Salary from Central Government	77,000	
Entertainment allowance	18,000	95,000
Less: Entertainment Allowance under Section 16(ii)		
Rs 5,000 or [1/5th of salary exclusive of any		
allowance, benefit or perquisite (Rs 35,000)]	5,000	(-) 13000
GROSS TOTAL INCOME		82,000
Less : Deduction under Section 80C (7,200 + 6,000)		-13,200
Total Income		68,800
Tax liability		Nil
Net tax payable		Nil

**Illustration 5:**

**Mr. A an employee of Ranchi [population 15 lakhs] based company provides the following particulars of his salary income:**

**Basic salary Rs 12,000 p.m; profit bonus Rs 12,000; commission on turnover achieved by Mr. A Rs 42,000, entertainment allowance 2,000 p.m; club facility 6,000; transport allowance Rs 1,800 p.m; free use of car more than 1.6 lt capacity for both personal and employment purposes and expenses are met by the employer'; rent free house provided by employer.lease rent paid by employer 6,000 p.m; 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 by the employer 16,800 ; compute income from under salary.**

**Solution :** Computation of salary income of Mr. A for the assessment year 2020-21

Salary	144,000
Profit bonus	12,000
Commission	42,000
Entertainment allowance	24,000
Club facility – taxable	6,000
Transport allowance – fully taxable	21,600
Car perquisite – big car @ Rs 2,400 p.m	28,800
Education facility for children	22,500
Gas, water and electricity bill paid by employer	16,800
Rent free house	36,540
Gross salary	354,240
Less: deduction u/s 16	40,000
Salary income	314,240

### Calculation of rent free house

**Salary for rent free house = salary + profit bonus+ commission + club facility + transport allowance**

$$= 144,000+ 12,000+ 42,000 + 24,000 +21,600 = 243,600$$

**15 % of employee’s salary i.e., Rs 36,540 or rent paid by employer**

**Rs 72,000 w.e is less**

### Illustration 6

Mr. X , employee of a public ltd. Company at cuttack, received the following emoluments for the previous year 2019-20

Basica slary @ Rs 30,000 p.m; D.A as per terms of employment Rs 3,000 p.m; Bonus equal to 1 month’s salary 33,000; commission Rs 60,000; advance salary Rs 60,000; employee’s contribution in RPF Rs 48,000; employer’s contribution in RPF Rs 48,000; special allowance @ Rs 2,000 p.m; house rental allowance received @ Rs 10,000 p.m; rent paid by him @ Rs 12,000 p,m; entertainment allowance Rs 3,000 p.m;

During the year employer has provided him a Honda city car of 1,600 cc capacity with chauffeur which he uses for his personal purposes. Employer's expenditure of the running and maintenance of the car including salary of the driver is Rs 120,000 during the car. Cost of the car is Rs 750,000.

Interest credited to his RPF @ 12 % is Rs 30,000

Employer company has provided him free club facility which costed the company Rs 24,000 and free lunch for 300 days cost being Rs 150 per day.

During the previous year he has been provided a interest free loan of Rs 18,000 to purchase a motor cycle . In November 2019, his father ill (disease specified under Rule 3A) and he again got interest free loan of Rs 50,000 from his employer for the medical treatment of his father. Find out salary income

### Solution

#### Computation of salary income

Basic salary @ Rs 30,000 p.m	360,000
D.A @ Rs 3,000 p.m	36,000
Bonus	33,000
Commission	60,000
Advance salary	66,000
Employer's contribution in RPF in excess over 12 % of his salary (48,000 – 47,520)	480
Entertainment allowance	36,000
Special allowance	24,000
HRA	15,600
Car perks	195,000
Interest credited to RPF in excess of 9.5 % ( 30,000 – 23,750)	6,250
Club facility	24,000
Free lunch ( 45,000 – 15,000)	30,000
Interest free loan to buy motor cycle ( exempted as less than Rs 20,000)	-
Interest free loan for medical treatment ( exempted)	-
Gross salary	886,330
Less: deduction u/s 16	40,000
Salary income	846,330

### Calculation of HRA

- (i) HRA received Rs 120,000
- (ii) 40 % of employee's salary i.e. 158,400
- (iii) Rent paid in excess of 10 % of his salary  
( 144,000 - 39,600) = 104,400

$$\text{HRA} = 120,000 - 104,400 = 15,600$$

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## 2.8 SUMMARY

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As per Section 15, the income chargeable to income tax under the head salaries would include :

Any salary due to an employee from an employer or a former employer to an assessee during the previous year irrespective of the fact whether it is paid or not.

Any salary paid or allowed to the employee during the previous year by or on behalf of an employer, or former employer, would be taxable under this head even though such amounts are not due to him during the accounting year. Arrears of salary paid or allowed to the employee during the previous year by or on behalf of an employer or a former employer would be chargeable to tax during the previous year in cases where such arrears were not charged to tax in any earlier year.

However it would not include:

- Any salary paid in advance and included in the total income of any person for any previous year, shall not be included again in the total income of the person when the salary becomes due.

- Any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from the firm shall not be regarded as “salary” for the purposes of this section.

The salary of an employee is a separate source, distinct from other classes of income. The basis of liability under the head salaries is the employer-employee relationship. Before charging the particular income received by a person under this head, care must be taken to ensure that there exists such a relationship of employer and employee between the recipient and the payer of the income. The payments chargeable under the head salaries must be made between the persons who are in the relationship of employer and employee. Therefore, the amount received by an individual shall be treated as salary only if the relationship between payer and payee is of an employer and employee or master and servant. Employer may be an individual, firm, and association of persons, company, corporation, Central Government, State Government, public body or a local authority. Likewise, employer may be operating in India or abroad. The employee may be full time employee or part-time employee.

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## 2.9 GLOSSARY

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**Basis of Charge:** As per section 15, salary is taxable on due or receipt basis whichever is earlier. Under Section 15 the income chargeable to income tax under the head salaries would include any salary due to an employee from an employer or a former employer during the previous year irrespective of the fact whether it is paid or not.

– Different forms of salary:

- (A) **Basic Salary:** Basic salary is taxable in the hands of an employee.
- (B) **Allowance:** An allowance is defined as a fixed amount of money given periodically in addition to the salary for the purpose of meeting some specific requirements connected with the service rendered by the employee or by way of compensation for some unusual conditions of employment.

It is taxable on due/accrued basis whether it is paid in addition to the salary or in lieu thereon.

**(C) Perquisites:** The term “perquisites” includes all benefits and amenities provided by the employer to the employee in addition to salary and wages either in cash or in kind which are convertible into money. These benefits or amenities may be provided either voluntarily or under service contract. For income-tax purposes, the perquisites are of three types:

1. Tax-free perquisites
2. Taxable perquisites
3. Perquisites taxable under specified cases.

- Valuation of perquisites: The basic principles governing valuation of perquisites are as follows:
- The valuation is done on the basis of their value to the employee and not the employer’s cost for providing the same .The value of perquisite is included in the salary income only if the perquisite is actually provided to the employee.
- Perquisite which is not actually enjoyed by the employee (though the terms of employment provide for the same) cannot be valued and taxed in the employee’s hands. Therefore, where the employee waives his right of perquisite, he cannot be taxed thereon.
- Allowable deductions under the head Salaries: The following amounts shall be deducted in order to arrive at the chargeable income under the head ‘Salaries’.

(A) Standard deduction: Omitted

(B) Entertainment allowance

(C) Tax on employment or Professional Tax

**Provident Funds** are grouped under these heads –

- (a) Statutory provident fund.
- (b) Recognised provident fund
- (c) Unrecognised provident fund

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**2.10 SELF ASSESSMENT QUESTIONS**

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**Define ‘Salaries’**

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**Distinguish between statutory provident fund, recognized provident fund and unrecognized provident fund.**

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**Define the term perquisite and how are they treated for income tax purpose.**

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**Give the treatment of HRA under income tax purpose.**

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**What is profit in lieu of salary ?**

**Write a short note on**

- i) Taxability of Allowances**
- ii) Gross salary**
- iii) Deductions out of gross salary**
- Taxability of provident funds**

1. Savita submits the following information regarding her salary income :

Basic salary Rs 11,000 per month, City compensatory allowance Rs 150 per month, children education allowance Rs 400 per month (for 3 children), Reimbursement of medical expenses Rs 25,000. She was entitled to house rent allowance of Rs 6,000 per month from 1st April, 2015 to 31st August, 2015. However, she was paying a rent of Rs 7,000 per month for a house in New Delhi. With effect from 1st September, 2015, she was provided with an accommodation by the company for which the company was paying a rent of Rs 5,000 per month.

Compute her gross salary for the assessment year 2020-21

1. From the following particulars compute salary income
- (i) Basic salary Rs 25,000 p.m
  - (ii) Dearness allowance Rs 5,000 p.m ( enters Rs 3,000 p.m into pay for service benefits)
  - (iii) Bonus Rs 20,000
  - (iv) Salary in lieu of past accumulated leave Rs 15,000
  - (v) Entertainment allowance Rs 1,500 p.m
  - (vi) Reimbursement of conveyance expenditure incurred in performance of duties Rs 1,500 p.m
  - (vii) Furnished house at concessional rent of Rs 3,000 p.m in Chennai [ population above 25 lakhs) fair rental value Rs 6,500 p.m . cost of furniture Rs 350,000 . salary of garndener Rs 1,000 p.a

- (viii) Club bill paid by the employer Rs 7,200 p.a**
  - (ix) Contribution by employee and employer to RPF – 13 % each of salary**
  - (x) Reimbursement of medical expenses in respect of treatment of a notified disease Rs 20,000 ( Hospital is an approved one).**
  - (xi) Life insurance premium paid by employee – own life Rs 20,000 p.a; wife's life Rs 15,000 p.a; major son- Rs 12,000 p.a**
  - (xii) ELSS deposit Rs 20,000**
  - (xiii) Contribution to public PF Rs 24,000 p.a**
- 2. Mr. P chaudhary is employed in a firm at Kolkata and he furnishes the following particulars of his income for the assessment year 2020-21**
- (a) Salary received after deduction of his own contribution to RPF and income tax at source Rs 420,000**
  - (b) Income tax deducted at source Rs 18,000**
  - (c) Own contribution to RPF Rs 42,000**
  - (d) Employers contribution to RPF Rs 42,000**
  - (e) Dearness allowance at 50 % of first Rs 200,000 and 25 % of the remaining basic salary per year**
  - (f) Interest credited to RPF @12 % p.a**
  - (g) House rent allowance p.a [ rent Rs 10,000 p.m] 96,000**
  - (h) Reimbursement of medical expenses for eye surgery of his wife ( notified disease) ( hospital is notified) Rs 62,000**

- (i) Free refreshment during working hours Rs 9,600
- (j) Free services of sweeper and watchman – salary paid by employer is Rs 600 p.m and Rs 9,600 p.a respectively.
- (k) Free lunch during office hours , the cost of which is estimated at Rs 200 per meal for 300 days
- (l) Conveyance allowance Rs 24,000 and he does not spend anything
- (m) Premium paid on his policy of Rs 170,000 . He got LIC policy on 10-8- 2015 Rs 20,000.

Compute his salary income

#### 2.11 SUGGESTED READINGS

1. Singhanai V.K: Students' Guide to Income Tax; Taxmann, Delhi.
2. Prasad, Bhagwati: Income Tax Law & Practice; Wiley Publication, New Delhi.
3. Mehrotra H.C: Income Tax Law & Accounts; Sahitya Bhawan, Agra.
4. Study Material, Executive Programme, Tax Laws And Practice Module I, Paper 4: The Institute Of Company Secretaries Of India, New Delhi, [Www.Icsi.Com](http://www.icsi.com)

**HOUSE PROPERTY**

**STRUCTURE**

- 3.1 Introduction**
- 3.2 Objectives**
- 3.3 Annual Rental Value**
- 3.4 Municipal Rental Value (MRV)**
- 3.5 Fair Rental Value**
- 3.6 Standard Rent**
- 3.7 Expected Rental Value**
- 3.8 Treatment of Unrealized Rent**
- 3.9 Vacancy**
- 3.10 Interest on loan**
- 3.11 Deductions U/S 24**
- 3.12 Income from House Property**

### **3.13 Summary**

### **3.14 Glossary**

### **3.15 Self assessment questions**

### **3.16 Suggested Readings**

## **3.1 INTRODUCTION**

House property consists of any building or land appurtenant thereto of which the assessee is the owner. The appurtenant lands may be in the form of a courtyard or compound forming part of the building. But such land is to be distinguished from an open plot of land, which is not charged under this head but under the head “Income from Other sources” or “Business Income”, as the case may be. Besides, “house property” includes flats, shops, office space, factory sheds, agricultural land and farm houses. Further, house property includes all type of house properties, i.e., residential houses, godowns, cinema building, workshop building, hotel building, etc. Income from house property is taxable in the hands of its legal owner in whose name the property stands. “Owner” for this purpose means a person who can exercise the rights of the owner not on behalf of the owner but in his own right. A person entitled to receive income from a property in his own right is to be treated as its owner, even if no registered document is executed in his name. The following three conditions must be satisfied before the income of the property can be taxed under the head “Income from House Property”:

- The property must consist of buildings and lands appurtenant thereto;
- The assessee must be the owner of such house property;

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

profession, it shall not be chargeable to tax. Ownership includes both free-hold and lease-hold rights and also includes deemed ownership. The provisions for computation of Income from house property are covered under sections 22 to 27. This chapter deals with the provisions for computation of Income from house property. Section 22 is the charging section that identifies the basis of charge wherein the annual value is prescribed as the basis for computation of Income from House Property. Therefore, the process of computation of “Income from House Property” starts with the determination of annual value of the property. The concept of annual value and the method of determination are laid down in section 23. The admissible deductions available from house property are mentioned in section 24. The present chapter provides the basics of all the important heads covered under the calculation of Income From House Property.

### **3.2 OBJECTIVES**

After going through the lesson the students will be able to have

- The knowledge about the various provisions for computation of Income from House Property
- An understanding of basic concepts covered under the head Income from House Property
- The practical acquaintance about the calculation of Income from House Property

### **3.3 ANNUAL RENTAL VALUE - Sec 2(2)**

Inherent capacity of the property to earn income is termed as its “annual value”, and has been defined as the sum for which the property may reasonably be let out. Where a person owns more than one property, the annual value of any one house property, as specified by her, will be considered “nil”. Other properties will attract tax on their annual values. The Gross Annual Value (GAV), also called the Annual Rental Value, of a property is used in calculating the tax or rent

which should be applied to the property. Annual value is determined to compute income under the head Income from House Property. The annual value of property consisting of any building or lands appurtenant thereto of which the assessee is the owner shall be subject to Income-tax under the head “Income from House Property” after claiming deduction under Sec. 24, provided such property or any portion of such property is not used by the assessee for the purpose of any business or profession, carried on by him, the profits of which are chargeable to Income-tax.

### **Definition**

Annual Rental value or Annual Value in relation to any property, means its annual value as determined under Section 23 of Income Tax Act, 1961 defines annual value as:

- (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 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 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 him) 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 therefrom 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.]

In general Income from house property is taxable on the basis of annual value. Even if the property is not let out, notional rent receivable is taxable as its annual value. As per Sec. 23(1) (a) the annual value of any property shall be the sum for which the property might reasonably be expected to be let out from year-to-year. In determining the annual value there are four factors which are normally taken into consideration.

These are: i) Actual rent

received or receivable,

ii) Municipal value,

iii) Fair rent of the property,

iv) Standard rent.

#### **Computation of annual value of a property [Sec. 23(1)]**

As per the Act the annual value is the value after deduction of Municipal taxes, if any, paid by the owner. But for the sake of convenience, the annual value may be determined in the following steps:

Step I: Determine the gross annual value.

Step II: From the gross annual value compared in Step I, deduct Municipal tax actually paid by the owner during the previous year. The balance shall be the net annual value which, as per the Income-tax Act is the annual value.

<b>ILLUSTARTION 1:</b>	
Mrs. X has let out one house property @ Rs. 62,000 p.m., Municipal Valuation Rs. 72,000 p.m., Fair Rent Rs. 90,000 p.m., Standard rent Rs. 1,00,000 p.m., Municipal Tax paid Rs. 40,000. Compute Net Annual Value.	
Solution:-	
Computation of Income under the head House Property:	
Particulars	Rs.
Gross Annual Value	10,80,000
Working Note: Rs.	
a) Fair Rent (Rs. 90,000 *12)	10,80,000
b) Municipal Value (Rs. 72,000 *12)	8,64,000
c) Higher of a) or b)	10,80,000
d) Standard Rent (Rs. 1,00,000 *12)	12,00,000
e) Expected Rent (Lower of c or d)	10,80,000
f) Rent received/receivable (Rs. 62,000 *12)	7,44,000
Gross Annual Value shall be higher of e) or f)	10,80,000
Less: Municipal Tax	40,000
Net Annual Value	10,40,000

**The annual value has to be determined for different categories of properties**

**These categories are:**

**Category A. House property** - Let out throughout the previous year.

**Category B. House property**- Let out and was vacant during the whole or part of the previous year

**Category C. House Property**- Part of the year let out and part of the year occupied for own residence

**Category A.:- House property- Let out throughout the previous year**

**Step 1:** Determining the gross annual value:

According to Sec. 23(1), the annual value of any property shall be deemed to be:-

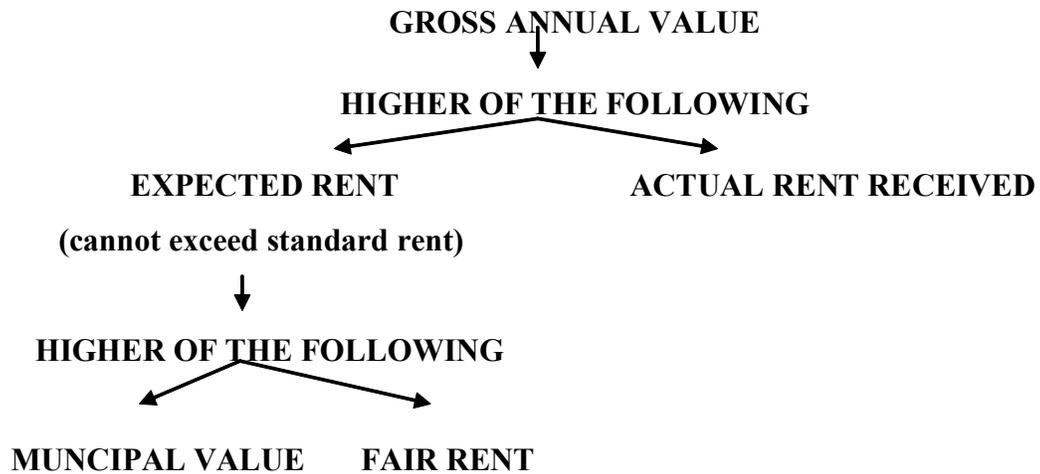
- (a) The sum for which the property might reasonably be expected to let out from year-to- year (i.e., expected rent); or
- (b) Where the property or any part of the property is let out and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause a), the amount so received or receivable, i.e., the actual rent.

For calculating Gross Annual Value of the property which is let out, first calculate expected rent as per clause (a) above and then compare the same with the actual rent received or receivable as per clause (b). If the actual rent so received or receivable as per clause (b) is more than the expected rent computed as per clause (a), the Gross Annual Value shall be the actual rent so received or receivable. On the other hand, if the actual rent so received or receivable is less than the expected rent, then the Gross Annual Value shall be expected rent so computed.

**Step 2:** Taxes levied by any local authority in respect of the property, i.e., Municipal taxes (including taxes levied for services) to be deducted. Municipal taxes, etc., levied by local authority are to be deducted from the gross annual value calculated as above, if the following conditions are fulfilled:

- a) the Municipal taxes have been borne by the owner, and
- b) these have been actually paid during the previous year.

Therefore, deduction for Municipal taxes, etc., levied by any local authority is allowed if they are borne and actually paid by the owner. It must be noted that the taxes are allowed as deduction only in the previous year in which these are paid. Municipal taxes, etc., due but not paid shall not be allowed as deduction. However, Municipal taxes, etc., paid during the previous year are allowable even if they relate to past years or future years.



**Illustration**

Mr. X is the owner of three houses, which are all let out and not governed by the Rent Control Act. From the following particulars find out the gross annual value in each case:

Particulars	I	II	III
Municipal Value		30,000	20,000
35,000			
Actual (De facto) Rent	32,000	28,000	30,000
Fair Rent	36,000	24,000	32,000

**Solution:**

**Gross Annual Value (GAV): Higher of Expected or Actual Rent**

**Expected Rent: Higher of Municipal Valuation or Fair Rent**

House I: ` 36,000

House II: ` 24,000

House III: ` 35,000

Actual Rent (given)

**GAV:**

House I: ` 36,000

House II: ` 28,000

House III: ` 35,000

**Illustration 2**

Mr. X is the owner of four houses, which are all let out and are covered by the Rent Control Act. From the following particulars find out the gross annual value in each case, giving reasons for your answer:

Particulars	I	II	III	IV
Municipal Value	30,000	26,000	35,000	30,000
Actual (De Facto) Rent	40,000	30,000	32,000	32,000
Fair Rent	36,000	28,000	30,000	36,000
Standard Rent	30,000	35,000	36,000	40,000

As all the houses are covered by the Rent Control Act, their gross annual value will be higher of expected Rent or Actual Rent. Expected Rent Shall be higher of Municipal Value or Fair rent but subject to Standard Rent:

Particulars	I	II	III	IV
Expected Rent	30,000	28,000	35,000	36,000
Actual Rent	40,000	30,000	32,000	32,000
G.A.V.	40,000	30,000	35,000	36,000

**Category B.:-** House Property- Let out and was vacant during the whole or part of the previous year:

According to Sec. 23(1), the annual value of such house property shall be deemed to be:-

- a) the sum for which the property might reasonably be expected to let out from year-to-year, i.e., the expected rent; or
- b) where the property or any part of the property is let out 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, i.e., the actual rent; or
- c) where the property or any part of the property is let out 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, i.e., the actual rent, if any. From the perusal of the above, the following two scenarios emerge:-

Scenario 1: Where the property is let out and was vacant for part of the year and the actual rent received or receivable is more than the sum determined under clause (a) in spite of vacancy period. In this case, clause (c) shall not be applicable as it will be applicable only when actual rent received or receivable is less than the sum referred under clause (a). Hence, the gross annual value in this case shall be:

- 1) the sum for which the property might reasonably be expected to be let out from year-to-year; or
- 2) actual rent received or receivable, whichever is higher

**ILLUSTRATION 2**

Municipal Value of house is Rs.1,00,000, Fair Rent Rs. 1,40,000, Standard Rent Rs.1,30,000. The house property has been let out for Rs.13,000 p.m. and was vacant for one month during the previous year 2018-19. Municipal taxes paid during the year were Rs. 50,000. Compute the annual value for assessment year 2020-21.

Solution:-

Particulars	Rs.
Gross Annual Value	
<b>Working Note:</b>	
a) Fair Rent	1,40,000
b) Municipal Value	1,00,000
c) Higher of a) or b)	1,40,000
d) Standard Rent	1,30,000
e) Expected Rent (Lower of c or d)	1,30,000
f) Rent received/receivable	1,43,000
Gross Annual Value shall be higher of e) or f)	1,43,000
Less: Municipal Tax	50,000
Net Annual Value	93,000

**Scenario 2:** Where the property is let out and was vacant for whole or part of the year and the actual rent received or receivable owing to such vacancy is less than the sum determined under clause (a). The annual value of the property shall be determined under this situation if all the following 3 conditions are satisfied:

- 1) The property is let out;
- 2) It was vacant during the whole or part of the previous year;
- 3) Owing to such vacancy, the actual rent received or receivable is less than the value determined under clause Sec. 23(1) (a).

In this case, both clause (a) and clause (b) shall not be applicable but clause (c) shall be applicable and the gross annual value shall be the actual rent received or receivable.

<b>ILLUSTRATION 3</b>	
<b>Consider the above illustration 2 and assume that the property was vacant for 3 months.</b>	
<b>Determine the annual value for the assessment year 2019-20</b>	
<b>Solution:-</b>	
<b>Particulars</b>	<b>Amount (Rs.)</b>
a) Expected rent (as determined above)	1,30,000
b) Actual rent received/receivable (Rs. 13,000 x 9)	1,17,000
As the actual rent received or receivable owing to vacancy is less than the sum determined under clause (a), it will fall under situation 2, i.e., Sec. 23 (1) (c) and, therefore, net annual value shall be determined as under:	
<b>Particulars</b>	<b>Amount (Rs.)</b>
Actual rent receive or receivable	1,17,000
Less:- Municipal Taxes Paid	50,000
<b>Net Annual Value</b>	<b>67,000</b>

**Category C.:-** House Property- Let out for part of year and rest of the year occupied for own residence

Where a house property is let out for part of the year and rest of the year occupied for own residence, its annual value shall be determined as per the provision of Sec. 23(1) relating to let out property. In this case the period of occupation of property for own residence shall be irrelevant and the annual value of such house property shall be determined as if it is let out for part of the year. Hence, the expected rent as per Sec. 23(1) (a) shall be taken for full year but the

actual rent received or receivable shall be taken only for the period it is let out and the gross annual value shall be higher of these two.

**ILLUSTRATION**

R has a house property in Delhi whose Municipal Value is Rs. 1,20,000 and the Fair Rental Value is Rs. 1,40,000. It was self occupied by R. From 1.4.2018 to 31.7.2018. W.e.f. 1.8.2018 it was let out at Rs.10,000 p.m. Compute the annual value of the house property for assessment year 2020-21 if the Municipal taxes paid during the year were Rs.40,000.

**Solution:-**

Particulars	Amount (In Rs.)
The gross annual value	
higher of the following two:	
a) Expected rent	
(Municipal Value Rs. 1,20,000 or FRV Rs. 1,40,000,	
whichever is higher)	1,40,000
b) Actual rent received/receivable for let out period,	
i.e., Rs. 10,000 x 8 =	80,000
Gross Annual Value a) or b), whichever is higher)	1,40,000
Less: Municipal Taxes	40,000
Net Annual Value	1,00,000

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### 3.4 MUNICIPAL RENTAL VALUE (MRV)

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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 (MRV).

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### **3.5 FAIR RENTAL VALUE (FRV)**

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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 (FRV).

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### **3.6 STANDARD RENT**

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The rent fixed under Rent Control Act is Standard rent.

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### **3.7 EXPECTED RENTAL VALUE (ERV)**

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The expected rental value shall be determined as follows:

- 1) In case standard rent has not been fixed (higher of the following is ERV).
  - a) Municipal rental value
  - b) Fair rental value
  - c) Actual rent received
- 2) In case standard rent has been fixed
  - a) Municipal rental value
  - b) Fair rental value
  - c) Standard rent

In case standard rent has been fixed, the ERV cannot exceed standard rent. In this case firstly we have to compare MRV and FRV and find out the higher one and the amount so calculate can not exceed the amount of standard rent. In case actual rent received is more than standard rent, then actual rental value shall be treated as ERV.

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### **3.8 UNREALIZED RENT**

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As per section 23 of the IT act,1961, unrealized rent is the amount of rent which the owner cannot realise shall be equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrecoverable where,—

- (a) the tenancy is bona fide;
- (b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;
- (c) the defaulting tenant is not in occupation of any other property of the assessee;
- (d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.]

Unrealized rent is allowed to be deducted from actual rent received or receivable only if the following conditions are satisfied:

1. The tenancy is bona fide;
2. The defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;
3. The defaulting tenant is not in occupation of any other property of the assessee;
4. The taxpayer has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

Existing provisions of sections 25A, 25AA and 25B relate to special provisions on taxation of unrealised rent allowed as deduction when realised

subsequently, unrealised rent received subsequently and arrears of rent received respectively. Certain deductions are available thereon

It is proposed to simplify these provisions and merge them under a single new section 25A and bring uniformity in tax treatment of arrears of rent and unrealised rent. It is proposed to provide that the amount of rent received in arrears or the amount of unrealised rent realised subsequently by an assessee shall be charged to income-tax in the financial year in which such rent is received or realised, whether the assessee is the owner of the property or not in that financial year. It is also proposed that thirty per cent of the arrears of rent or the unrealised rent realised subsequently by the assessee shall be allowed as deduction. The amendment will take effect from first date of April, 2017 and will, accordingly, apply in relation to the assessment year 2017-18 and subsequent years.

**Treatment of Unrealised Rent of House Property Income Treatment Of Unrealised Rent Recovered [Upto Assessment Year 2001-02] [Section 25A]**

1. If amount of unrealised rent recovered is less than or equal to an amount, which was disallowed earlier, it shall not be taxable.
2. If amount unrealised rent recovered is more than the amount which was disallowed earlier, excess of amount realised 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.

**Treatment Of Unrealised Rent Recovered [From A/Y 2002-03 Onwards] [Section 25AA]**

It shall be deemed as income of the year in which recovered even if the assessee does not own the house property during the previous year in which such amount is realised.

While calculating deemed income from houses property for unrealised 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 unrealised rent.

### **Special Provision For Arrears Of Rent Received [Section 25B]**

In case any arrears of rent of any earlier years are recovered during the previous year, these are deemed as income from house property after allowing 30% as Standard deduction. Such arrears of rent shall be taxable in the hands of assessee even if he does not own the property (to which such arrears relate) during the previous year in which such arrears are recovered.

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.

### **Property Owned 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. Sec. 23(1) provides that unrealised rent should be deducted from clause (b) or clause (c) of Sec. 23(1), i.e., the actual rent received or receivable. It does not provide that it should be deducted from clause (a), i.e., from expected rent. Thus, problem will arise when gross annual value is to be taken as expected rent instead of actual rent received or receivable, as the assessee in that case cannot take the deduction of unrealised rent. However, in the income-tax return forms, unrealised rent has been shown as deduction from the gross annual value (i.e., after taking expected rent or actual rent, whichever is higher). It is, therefore,

recommended that unrealised rent should be deducted after computation of gross annual value. Similarly, where a house is vacant for part of the year, Sec. 23(1)(c) provides that gross annual value is to be taken as actual rent if the same is less than the expected rent. In this case also unrealised rent should be deducted after computation of gross annual value (i.e., the actual rent).

ILLUSTRATION:		
ABC furnishes the following particulars in respect of a house property owned by him in Delhi.		
Particulars	Amount (Rs.)	
Municipal Value	1,00,000	
Fair Rent	1,40,000	
Actual rent (per month)	11,000	
Municipal tax paid during the year	10,000	
The tenant vacated the property on 31.10.2019 and thereafter the property was let out for Rs. 15,000 p.m. ABC could not realise the rent for the months of September and October, 2019 due to the death of the earlier tenant. i) Compute the annual value of the property for the assessment year 2020-21. ii) What will be your answer if the unrealised rent is for one month instead of two months?		
SOLUTION		
Solution:-	(i)	(ii)
Particulars	Amount (In Rs.)	
Step I: Determine the value as per Sec. 23(1) (a)	It shall be Rs. 1,00,000 or Rs. 1,40,000, whichever is higher	
	1,40,000	1,40,000
Step II: Actual rent received/receivable (Rs. 11,000 x 7 + 15,000 x 5)	1,52,000	1,52,000
Gross Annual Value	1,52,000	1,52,000
	(i)	(ii)
Less: Unrealised Rent	22,000	11000
Less: Municipal Tax Paid	10,000	10000
	32,000	21000
Net Annual Value	1,20,000	131000

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### 3.9 VACANCY

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If you own more than one residential property, only one property can be treated as self-occupied for income tax purposes. The other properties will either be considered as let out or deemed to be let out, irrespective of whether you are occupying them, letting them out or leaving them vacant partially or for the whole year. Also, these properties will attract tax on their annual value. However, you are entitled to claim standard deduction of 30% and interest payment if you have taken a home loan to acquire that property, out of the annual value that will be taxed. Besides these, you can also claim for vacancy allowance. If the property remained vacant during the full or part of previous year, even after your best effort to let it out, you can claim deduction as vacancy allowance under section 23(1)(c) of the income tax Act. You will not have to pay tax on any notional rent for the period for which property remained vacant. But you have to make sure that Best effort has been made to make it rented.

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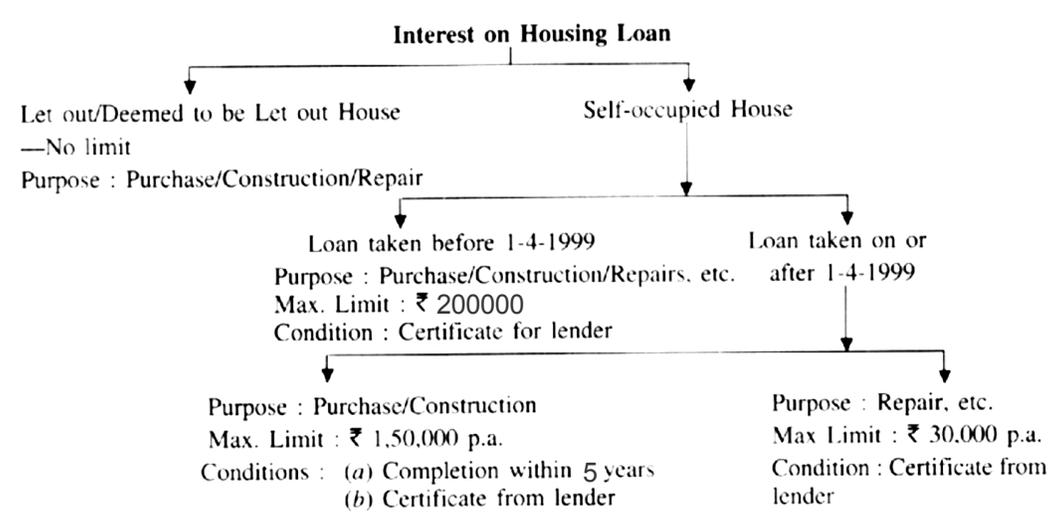
### 3.10 INTEREST ON LOAN

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#### **Treatment of Pre-acquisition/Pre-construction Period Interest**

**Meaning of ‘Pre-acquisition / pre-construction period’.** It means the period starting from the date of borrowing and ending on March 31st immediately preceding to the year of completion of construction/acquisition. *For example*, Mr. A has taken a loan on 1-4-2010 for construction of a house and the construction was completed on 1-07-2012. In this case, pre-construction period shall be the period starting from 1-04-2010 and ending on 31-3-2012. –**Important point.** The period from 1-04-2012 to 30-06-12 shall not be included in the preconstruction period. **Tax treatment.** Interest for pre-acquisition/pre-construction period shall be allowed as deduction in 5 equal installments starting from the previous year in which the house is acquired or the construction is completed and for the next 4 previous years. **Important point.** If the construction/acquisition of house is completed during a particular previous year then whole

interest of that previous year shall be treated as post-construction period interest. In other words, no part of that previous year's interest shall be treated as 'pre-acquisition period interest'.



**Note.** If the whole or any part of pre-acquisition / construction period interest is claimed as deduction under any other provision of the Act then that much interest shall not be allowed as deduction under the head house property.

### **Other Important Points**

- (i) **Basis of allowability.** Interest on housing loan is allowed as deduction on accrual basis. Thus, interest accrued/outstanding at end of the previous year is also allowed as deduction for that previous year. Even if an assessee maintains books of accounts on cash basis, the interest on housing loan shall be allowed as deduction on accrual basis.
- (ii) **Loan taken to repay the original loan.** Interest on new loan taken to repay the original housing loan is also allowed as deduction.
- (iii) **Interest on delayed payment of interest.** It is not allowed as a deduction.

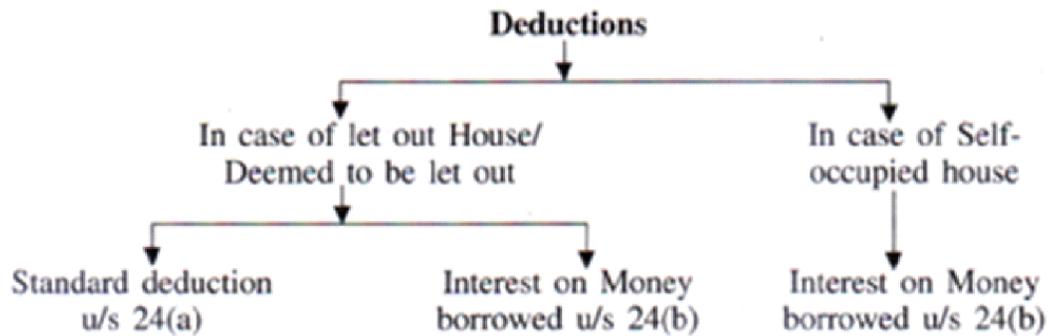
- (iv) **Who may be lender?** Housing loan may be taken from any lender, *i.e.*, the lender may be a bank or any financial institution, or any company, or any friend or relative of the assessee or any other person.
- (v) **Interest payable outside India (Section 25).** If interest on loan is payable outside India then deduction shall be allowed only if tax is deducted at source out of such interest. In other words, if interest is paid without deduction of tax at source then it shall not be allowed as deduction. However, the requirement of TDS is not necessary if there is any person in India who may be treated as an agent of the lender u/s 163 (who is outside India) in respect of such interest.
- (vi) **Applicability of Maximum limit.** In case of self-occupied house property, the maximum limit of interest is in respect of both pre-acquisition period interest and post-acquisition period interest.
- (vii) **Loan taken to repay outstanding interest on old housing loan.** Interest on such new loan is not allowed as deduction.
- (viii) Interest on loan shall be allowed on deduction out of the Net annual value of the house for which the loan has been taken. Thus, interest on loan taken for house A shall not be allowed as deduction out of net annual value of house B.
- (ix) Interest on money borrowed for the payment of municipal tax etc. is not allowed as deduction.

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### 3.11 DEDUCTIONS U/S 24

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**Out of Net Annual Value (NAV) of House Property Income** While calculating house property income, deductions are allowed out of net annual value (NAV). These deductions are as follows.



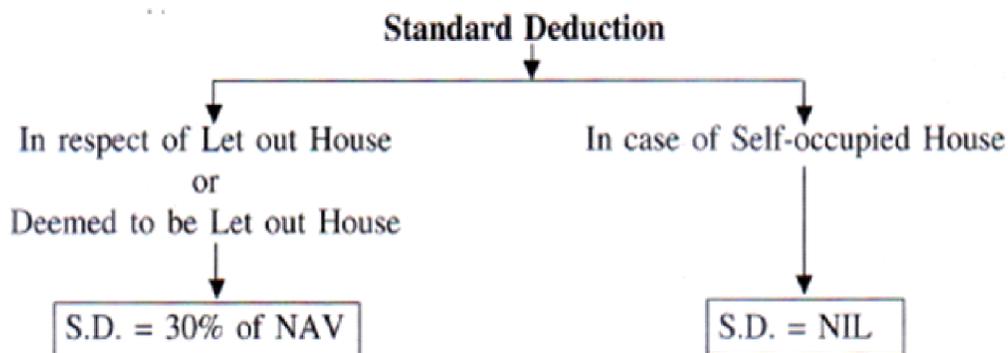
(1) **Standard Deduction [Sec. 24(a)]**

It is an adhoc/flat deduction available out of net annual value in respect of certain expenses of the owner of the house property connected with earning of rental income like rent collection charges, insurance of house, repair of house, etc. It is allowed @ 30% of 'net annual value'.

*Note. (1) Actual expenses incurred by the owner of house property are not to be considered. The Standard deduction is available even if the owner has not incurred any expense for earning rental income.*

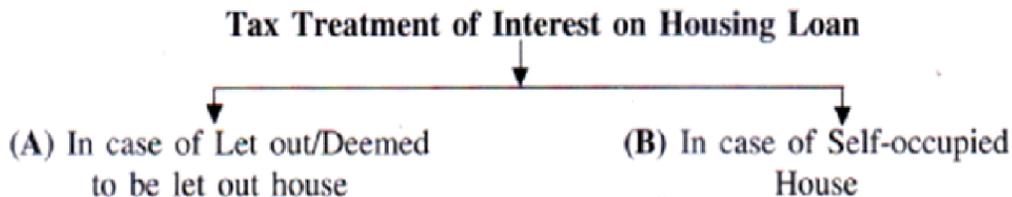
(2) No Standard deduction is allowed in respect of self-occupied house property because net annual value of self-occupied house is taken as NIL. Thus,

Standard Deduction



**(2) Interest on 'Housing Loan' [Section 24(b)]**

Housing loan means loan taken/amount borrowed for purchase, construction, repairs or renovation, etc. of house property. Interest paid/payable on housing loan is allowed as deduction while computing house property income. It is important to note that while calculating house property income in respect of let out house property/deemed to be let out house property, there is no maximum limit on interest, however, (while calculating house property income) in respect of self-occupied house, there is a maximum limit upto which interest can be claimed as deduction. The tax treatment of interest on housing loan can be explained as follows



**(A) Let Out/Deemed To Be Let Out House.**

While calculating house property income in respect of such house property, interest on loan taken for purchase / construction / repairs / renovation etc. is allowed as deduction in full. There is no maximum limit in respect of such interest.

**IMPORTANT POINTS**

- 1) Interest on housing loan is allowable as deduction on accrual basis not on paid basis (even if account books are kept on cash basis) if capital is borrowed for the purpose of purchase, construction, repair, renewal or reconstruction of the house property. Deduction can be claimed for two or more housing loans.

- 2) Interest includes service fees, brokerage, commission, prepayment charges etc.
- 3) Interest/penalty on unpaid interest shall not be allowed as deduction.
- 4) Deduction shall be allowed irrespective of the nature of loan whether it is housing loan or personal loan from any person/institution.
- 5) If a person instead of raising a loan from a third party pays sale price to the seller in instalments along with interest than such interest is also allowable.
- 6) Interest on borrowed money which is payable outside India shall not be allowed as deduction under section 24(b), unless the tax on the same has been paid or deducted at source and in respect of which there is no person in India, who may be treated as an agent of the recipient for such purpose.
- 7) For claiming deduction under this section, assessee must be the owner or deemed owner of the house property and loan shall be in the assessee name.

#### **Maximum Limit of deduction under section 24b**

These limits of deduction is applicable assessee wise and not property wise. Therefore if an assessee owns two or more house property then the total deduction for that assessee remain same.

- 1) In Let Out Property/Deemed to be Let Out – No maximum limit
- 2) Self Occupied House (SOP) – Rs. 2,00,000.

In the following cases the above limit of Rs 2,00,000 for SOP shall be reduced to Rs. 30,000

- i) Loan borrowed before 01-04-1999 for any purpose related to house property.

- ii) Loan borrowed after 01-04-1999 for any purpose other than construction or acquisition.
- iii) If construction/acquisition is not completed within 5 years from the end of the financial year (3 years till financial year 2015-16) in which capital was borrowed. For example, a loan is obtained for construction/acquisition on 28 Oct 2011 then the deduction limit should be reduced to Rs 30,000 if the construction/acquisition completes after 31 March 2017.

#### Extra Deduction of Rs. 50,000 on Home Loan Interest under Section 80EE

##### Interest on loan for pre construction/acquisition period

Interest for pre construction/acquisition period is allowable in 5 equal instalments beginning from the year of completion of house property. This deduction is not allowable if the loan is utilized for repairs, renewal or reconstruction.

Pre Construction/Acquisition period starts from the date of borrowing and ends on the last day of **preceding** Financial Year in which the construction is completed. For example, if house property is completed on 21st March 2012 then the deduction is allowed from Financial Year 2011-2012 to 2016-17.

##### **Deduction in case of Co-borrower**

If the home loan is taken on joint names then the deduction is allowed to each co-borrower in proportion to his share in the loan. For taking such deduction it is necessary that such co-borrower must also be co-owner of that property. If the assessee is a co-owner but is repaying the full loan himself, then he can claim the deduction of full interest paid by him.

The limit of deduction in case of Self occupied property applies individually to each co-borrower. In other words, each co-borrower can claim deduction upto Rs. 2 lakh/Rs. 30,000. No limit is applicable to let out property.

**Table: Deduction u/s 24b**

<b>Particulars</b>	<b>Section 24b</b>
Tax Deduction allowed only for	Interest
Basis of Tax Deduction	Accrual Basis
Amount of Deduction	Self occupied property : Rs. 2,00,000 (From assessment year 2019-20) Other than Self occupied property : No limit
Purpose of loan	Purchase/ Construction/ Repair/ Renewal/ Reconstruction of a Residential House Property.
Eligibility for claiming Tax deduction	Purchase/ Construction should be completed within 3 years
Restriction on Sale of Property	NIL
Deduction during construction period	Interest paid during the construction/acquisition period shall be allowed in 5 equal installment from the last day of preceding Financial Year in which the construction is completed

#### Interest Deduction with HRA

HRA under section 10(13A) and interest deduction can be availed simultaneously even if house property is in same city in which you resides on rented property.

Form 12BB is to be filed with employer if you want your employer to take deduction under this section into consideration and thus deduct lower TDS.

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### **3.12 INCOME FROM HOUSE PROPERTY**

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- A) Self occupied for residential purposes or which could not actually be self occupied owing to employment at other place [Sec. 23(2), (3) & (4)]**

**i) Where the annual value of such house shall be nil [Sec. 23(2)(a) & (b)]:**

Where the property consists of house or part of a house which:-

- a) is in occupation of the owner for the purposes of his own residence, or
- b) cannot actually be occupied by the owner 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 house shall be taken to be NIL.

**ii) Where the annual value of such house shall not be nil [Sec. 23(3)]**

The annual value of self-occupied house shall not be nil:

- a) if such house or part of the house is actually let out during the whole or any part of the previous year, or
- b) any other benefit thereon is derived by the owner from such house. In the above cases, the annual value shall be determined as per provisions applicable to let out properties

**iii) Where assessee has more than one house for self occupation [Sec. 23(4)]**

If there are more than one residential houses, which are in the occupation of the owner for his residential purpose, then he may exercise an option to treat any one of the houses to be self-occupied. The other house(s) will be deemed to be let out and annual value of such house(s) will be determined as per Sec. 23(1) (a), i.e., the sum for which the property might reasonably be expected to be let out from year-to-year. The assessee in this case, should exercise his option in such a manner that his taxable

income is the minimum. Such option may be changed from year-to-year. However, if the assessee has a house property which consists of two or more residential units and all such units are self occupied, the annual value of the entire house property shall be taken as nil as there is only one house property, though it has more than one residential units.

**iv) Deduction in respect of one-self occupied house where annual value is nil:**

Where annual value of one self-occupied house is nil, the assessee will not be entitled to the standard deduction of 30%, as the annual value itself is nil. However, the assessee will be allowed deduction on amount of interest (including 1/5th of the accumulated interest of pre-construction period) as under:-

<p>a) Where the property is acquired or constructed with capital borrowed on or after 1.4.1999 and such acquisition or construction is completed within 3 years of the end of the financial year in which the capital was borrowed.</p>	<p>Actual interest payable, subject to maximum Rs. 1,50,000 if certificate mentioned in point 2 in box given below is obtained.</p>
<p>b) In any other case, i.e., borrowed for repairs or renewal or conditions mentioned in clause (a) are not satisfied.</p>	<p>Actual interest payable subject to maximum of Rs. 30,000</p>

<b>Example: Y has two houses, both of which are self-occupied. The particulars of the houses are as under:</b>		
<b>Particulars</b>	<b>Ist House</b>	
<b>Amount (Rs.)</b>	<b>IInd House</b>	
<b>Amount (Rs.)</b>	<b>Municipal Value 70,000 1,00,000</b>	
<b>Fair Rental Value 82,000 1,30,000</b>	<b>Standard Rent - 1,10,000</b>	
	<b>Date of completion 1.1.1994 1.10.1994</b>	
<b>Municipal taxes 7,000 and 10,000</b>	<b>paid during the year</b>	
<b>Suggest which house should be opted by Y to be assessed as self-occupied so that his tax liability is minimum.</b>		
<b>Solution:- Assume both houses to be let out</b>		
<b>Particulars</b>	<b>Deemed to be let out</b>	<b>Deemed to be let out</b>
	<b>Ist House</b>	<b>IInd House</b>
<b>Gross Annual Value</b>	<b>82,000</b>	<b>1,10,000</b>
<b>Less: Municipal Taxes</b>	<b>7,000</b>	<b>10,000</b>
<b>Net Annual Value</b>	<b>75,000</b>	<b>1,00,000</b>
<b>Less: Statutory Deduction @30%</b>	<b>22,500</b>	<b>30,000</b>
<b>Net Annual Value</b>	<b>52,500</b>	<b>70,000</b>
<b>If house I is opted to be self occupied the income of house property shall be :</b>		
<b>Particulars</b>	<b>Amount (Rs.)</b>	
<b>House I</b>	<b>Nil</b>	
<b>House II</b>	<b>70,000</b>	
<b>Income from House Property</b>	<b>70,000</b>	
<b>If house II is opted to be self occupied the income of house property shall be:</b>		
<b>Particulars</b>	<b>Amount (Rs.)</b>	
<b>House I</b>	<b>52,500</b>	
<b>House II</b>	<b>Nil</b>	
<b>Income from House Property</b>	<b>52,500</b>	

**B) Computation of income of house property which is partly let out and partly self occupied**

In this case the annual value, deductions and the income of the part of the property which is let out shall be computed separately under the let out property e.g. Where one unit is let out and the other unit is self occupied, the whole property cannot be taken as a single unit. Municipal value or fair rent if not given separately, shall be apportioned between the let out portion and self occupied portion on built-up area basis. Similarly, where, in a building the ground floor is self-occupied and the first floor is let out or vice-versa, such a property shall not be treated as a single unit. Instead, income from first floor which is let out shall be computed separately as per let out provisions and the floor which is self-occupied shall be computed separately as per self-occupied provisions. Municipal tax and interest shall also be apportioned on the basis of built-up/floor area.

When a portion of the house is self-occupied for the full year and a portion is self-occupied for whole year, the annual value of the house shall be determined as under:

- (i) From the full annual value of the house the proportionate annual value for self-occupied portion for the whole year shall be deducted.
- (ii) The balance under (i) shall be the annual value for let out portion for a part of the year.

**Illustration**

Mr. R. owns a house. The Municipal value of the house is ` 50,000. He paid `8,000 as local taxes during the year. He uses this house for his residential purposes but lets out half of the house @ ` 3,000 p.m. Compute the annual value of the house.

**Solution**

Annual rent or Municipal valuation (which is higher)	72,000
Less : Local taxes paid	8,000
Annual value of House Property	64,000
Less : Half of annual value regarding self occupied portion for the whole year	32,000
Annual Value of let out portion	12,000

House let out during any part of the previous year and self occupied for the remaining part of the year. In this case the benefit of Section 23(2) is not available and the income will be computed as if the property is let out.

**Illustration**

M is the owner of a house. The municipal value of the house is ` 40,000. He paid ` 8,000 as local taxes during the year. He was using this house for his residential purposes but let out w.e.f. 1.1.2013 @ ` 4,000 p.m. Compute the annual value of the house.

<b>Solution</b>	
<b>Annual rent or municipal valuation (whichever is higher)</b>	<b>48,000</b>
<b>Less : Local taxes</b>	<b>8,000</b>
<b>Annual value of the house</b>	<b>40,000</b>
<b>(No benefit shall be given for self occupied period as the house did not remain vacant during the previous year). Note: If fair rent is not given, then assume actual rent as fair rent.</b>	

- C) Interest when not deductible from “Income from House Property” [Sec. 25]

Interest on borrowed money which is payable outside India shall not be allowed as deduction u/s 24(b), unless the tax on the same has been paid or deducted at source and in respect of which there is no person in India, who may be treated as an agent of the recipient for such purpose.

- D) Unrealised rent received subsequently to be charged to income-tax [Sec. 25AA]. Where the assessee could not realise rent from a property let to a tenant and the same was allowed as deduction and, subsequently, the assessee has realised any amount in respect of such rent, the amount so realised shall be deemed to be the income chargeable under the head “Income from house property” and, accordingly, charged to income-tax as the income of that previous year in which such rent is realized, whether or not the assessee is the owner of that property in the previous year.

- E) Special provisions for arrears of rent received [Sec. 25B]

Where the assessee:

- a) is the owner of an property consisting of any buildings or lands appurtenant thereto which has been let out to a tenant; and

b) has received any amount, by way of arrears of rent from such property, not charged to income-tax for any previous year; the amount so received, after deducting a sum equal to 30% of such amount, shall be deemed to be the income chargeable under the head income from house property. Further, it will be charged to income-tax as the income of that previous year in which such rent is received, whether the assessee is the owner of that property in that year or not.

F) Property owned by co-owners [Sec. 26]

Sometimes the property consisting of buildings or the buildings and land appurtenant thereto is owned by two or more persons, who are known as co-owners. In such cases, if their representative shares are definite and ascertainable, such persons shall not be assessed as an AOP in respect of such property, but the share of each such person in the income from the property, as computed in accordance with Sec. 22-25, shall be included in his total income as under:-

a) Where house property is self occupied by each co-owner:- Where the house property owned by the co-owners is self occupied by each of the co-owner, the annual value of the property for each of such of co-owner shall be nil and each of the co-owner shall be entitled to the deduction of Rs. 30,000/ 1,50,000 under Sec. 24(b) on account of interest on borrowed money.

b) Where the entire or part of the property is let out:- As regard, the property or part of the property which is owned by co-owners is let out, the income from such property or part thereof shall be first computed as if this property or part thereof is owned by one owner and thereafter the income so computed shall be apportioned amongst each co-owner as per their definite share. The Annual Value (NAV) can be negative only when Municipal taxes paid by the owner are more than the gross annual value.

**TABLE 2: Income from house property**

s.no	Property Type	Gross AV of the property	Deduction for municipal taxes	Net AV of the property	Standard Deduction	Standard Deduction
1	Two self-occupied House	NIL	NIL	NIL	NIL	NIL
2	House property could not be occupied by the owner due to employment or business carried on at any other place	NIL	NIL	NIL	NIL	NIL
3	Let out property	To be computed as per provisions of Section 23(1)	Allowed on actual payment basis	Gross annual value less: Municipal taxes	30% of Net Annual Value	30% of Net Annual Value
4	More than one Self occupied Property	Only one property selected by the taxpayer will be considered as self occupied house property and all other properties shall be deemed to be let -out for the purpose of computation of income under the head house property.				
5	A self-occupied property let-out for the part of the year	The house will be taken as let -out property and no concession shall be available for the duration during which the property was self-occupied.				
6	One part of the property is let -out and	Each part of the property shall be considered as separate property and income will be computed accordingly				

Chart Showing Computation of Taxable Income from House Property	
Gross Annual Value of the house	XXX
Less: Local Taxes paid by the owner during the previous year	XXX
Annual Value	XXX
Less: Deduction under Section 24:	
For house let out or deemed to be let out:	
(i) Repairs and Collection Charges (30% of Annual Value)	XXX
(ii) (a) Interest on loan, taken for purchase, construction of repair of the house, relating to previous year	XXX
(b) Interest on loan for the period prior to the previous year in which the house is completed is also allowable in five equal annual instalments	XXX      XXX
Taxable Income from House Property	XXX

#### ILLUSTRATION

ABC is a marketing officer at Lucknow. He owns two residential houses. The first is in Delhi and was constructed on 31.12.1991. This has been let out on a rent of Rs. 3,000 p.m. to a company for its office. The second house is in Lucknow which was constructed on 1.3.2011 and has been occupied by him as his own residence since then. He took a loan of Rs. 90,000 on 1.8.2009 @ 8% per annum interest for the purpose of construction of this house. The entire loan is still outstanding. Other relevant particulars in respect of these houses are given below:

Particulars	Ist House Amount (Rs.):-	IInd House Amount (Rs.)
Municipal Valuation	24,000	18,000
Municipal Tax	10% of Municipal Value	8% of Municipal Value
Expenses on repairs	2,000	6,000
Fire Insurance Premium	200	--
Ground Rent	175	130
Land Revenue	1,000	650
Interest on Loan	--	7,200

The ground rent of the Delhi house and Municipal tax and land revenue of the Lucknow house are unpaid. ABC was transferred to Mumbai on 1.12.2011 where he resides in a house at a monthly rent of Rs. 4,000 and his house at Lucknow was let out on the same day on rent of Rs. 2,000 per month. Compute the “Income from house property” in respect of Mr. ABC.

**Solution:**

Particulars	Amount (Rs)	Amount (Rs.)
<b>Ist House (Let Out)</b>		
Gross Annual Value (Rent Received)	36,000	
Less:- Municipal Taxes	2,400	
Net Annual Value	33,600	
Less:- Deduction u/s 24		
Statutory Deduction @ 30%	10,080	
<b>(I) Income from House Property</b>		<b>23,520</b>
<b>IInd House (Part of the year let out and part Of the year self occupied)</b>		
Particulars	Amount (Rs.)	Amount (Rs.)
<b>Gross Annual Value higher of the following two:</b>		
a) Municipal value or Fair rent, whichever is more, i.e., Rs 18,000 or Rs. 24,000	24000	
b) Actual rent received or receivable 2,000 *4 (higher of fair rent of actual rent)	8000	24000
Less:- Municipal taxes		nil
Net Annual Value		24000
Less:- Deduction u/s 24		
a) Statutory Deduction @30%	7200	
b) Interest on Loan (7,200+960)	8160	15360
<b>(II) Income from House Property</b>		<b>8640</b>
<b>Total income from house property = I + II = 32160 (23520+8640)</b>		

<b>Illustration:</b>				
<b>Mr. X is the owner of four houses. The following particulars are available:</b>				
	<b>House 1</b>	<b>House 2</b>	<b>House 3</b>	<b>House 4</b>
<b>Municipal valuation</b>	<b>16,000</b>	<b>20,000</b>	<b>24,000</b>	<b>5,600</b>
<b>Rent (Actual)</b>	<b>—</b>	<b>14,000</b>	<b>20,000</b>	<b>6,800</b>
<b>Municipal taxes</b>	<b>400</b>	<b>1,000</b>	<b>1,200</b>	<b>300</b>
<b>Repairs and collection charges</b>	<b>200</b>	<b>2,500</b>	<b>1,040</b>	<b>460</b>
<b>Interest on mortgage</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>1,000</b>
<b>Ground rent</b>	<b>—</b>	<b>100</b>	<b>—</b>	<b>60</b>
<b>Fire premium</b>	<b>140</b>	<b>—</b>	<b>200</b>	<b>—</b>
<b>Annual charges</b>	<b>—</b>	<b>—</b>	<b>360</b>	<b>—</b>
<b>House No. 1 is self-occupied.</b>				
<b>House No. 2 is let out for business, construction was completed on 1.3.92 and consists of two residential units.</b>				
<b>House No. 3 is 3/4 used for own business 1/4 let out to the manager of the business.</b>				
<b>House No. 4 is let out for residential purposes.</b>				
<b>His other income is ` 30,000. Find out the income of X from house property for the assessment year 2019-20</b>				
Solution				
Computation of income from house property for the assessment year 2019-20				
Gross annual value: to be higher of the following:				
	Rs		Rs	
(a) Municipal valuation ` 80,000 or				
(b) De facto rent ( ` 1,20,000 less value of amenities)				
i.e Rent Received:			1,20,000	
Less: Value of the amenities provided by the assessee:				
(i) Extension of water connection not deductible as it is capital expenditure				
(ii) Water charges	1,500			
(iii) Lift maintenance	1,500			
(iv) Salary of gardener	1,800			

(v) Lighting of stairs	1,200	
(vi) Maintenance of swimming pool	750	(6,750)
Gross annual value		1,13,250
Less: Local tax `16,000:		
No deduction is permissible as the taxes have been paid by the tenant		—
Net annual value		1,13,250
Less: Standard deduction from net annual value:		
30% of Net Annual Value		(33,975)
Income from house property	79,275	

#### ILLUSTRATION

Mr. and Mrs. O.P. Gupta are co-owners of a property having equal shares. The construction of the property was begun in July 1993 and completed in September 1998. They furnished the following particulars for the assessment year 2019-20 in respect of the property.

One-third of the property is occupied by the co-owners and the remaining two-thirds is let for residential purposes. The let out portion which constitutes two units fetches rent of ` 27,000 per annum. The letting value of the property as per municipal records is ` 36,000. Municipal taxes of Rs 4,050 have been paid by the co-owners.

Besides, they paid Rs 1,350 as ground rent and Rs 900 as insurance premium. The co-owners also paid Rs 9,000 as interest on loan taken for the construction of the house.

Compute the income from the house property from the assessment year 2020-21 if other incomes of Mr. and Mrs. O.P. Gupta are Rs 60,000 and Rs 22,500 respectively during the same period.

Solution

Computation of income from house property for the assessment year 2020-21

#### LET OUT PORTION

Gross annual value: To be higher of the following:

a) Notional income based on municipal valuation

$$2/3 \times ` 36,000 = ` 24,000 \text{ or}$$

(b) Annual rent = ` 27,000

Gross Annual Value 27,000

Less: Full municipal taxes paid by the co-owners		
$2/3 \times ₹ 4,050 = ₹ 2,700$		(2,700)
Net Annual Value		24,300
Less: Deduction from net annual value:		
(i) 30% of Net Annual Value	7,290	
(ii) Interest on loan taken for the construction of the house $2/3 \times ₹ 9,000 = ₹ 6,000$	6,000	(13,290)
Taxable income		11,010
Share of Mr. Gupta = Rs 5,505		
Share of Mrs. Gupta = Rs 5,505		

#### SELF-OCCUPIED PORTION

Gross annual value: to be higher of the following:

(i) Municipal valuation:

$1/3 \times ₹ 36,000 = ₹ 12,000$  or

(ii) Fair rent ( $₹ 27,000 \times 3/2 \times 1/3$ ) = ₹ 13,500

Gross Annual Value		13,500
Annual Value		13,500
Share of	Share of	
	Mr. Gupta	Mrs. Gupta

Apportionment of Annual value

among the co-owners 1 : 1

	6,750	6,750
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Annual value of self-occupied property for each

co-owner is taken to be [Section 23(2)(a)(i)

read with explanation to Section 26]

	Nil	Nil
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Less: Deduction from net annual value:		
Interest on loan	1,500	1,500
Loss: under the head house property	( - )1,500	( - )1,500
Statement of total income from house property:		
	5,505	5,505
Let out portion	( - )1,500	( - )1,500
Self-occupied portion Loss:		
	4,005	4,005

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### 3.13 SUMMARY

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Sec.22 defines the term house property as follows: house property consists of any building or land appurtenant thereto of which the assessee is the owner. The appurtenant lands may be in the form of a courtyard or compound forming part of the building. But such land is to be distinguished from an open plot of land, which is not charged under the head but under the head „Income from Other Sources or „Business Income , as the case may be. Besides, house property includes flats, shops, office space, factory sheds, agricultural land and farm houses. Income from house property is taxable in the hands of its legal owner in whose name the property is registered. “Owner” for this purpose means a person who can exercise the rights of the owner not on behalf of the owner but in his own right. Sec.22 defines the term house property as follows: house property consists of any building or land appurtenant thereto of which the assessee is the owner. The appurtenant lands may be in the form of a courtyard or compound forming part of the building. Besides, house property includes flats, shops, office space, factory sheds, agricultural land and farm houses. Thus, Any income which

needs to be taxed under the head “Income from House Property” needs to satisfy following three conditions:

- The property must consist of buildings and lands appurtenant thereto;
- The assessee must be the owner of such house property;
- The property may be used for any purpose, but it should not be used by the owner for
- the purpose of any business or profession, the profit of which are chargeable to tax.

If the property is used for own business or profession, it shall not be chargeable to tax. Income chargeable under the head “Income from house property” shall be computed after making the following deductions, namely:-

- a. Standard Deduction
- b. Interest on borrowed capital

From the net annual value computed, the assessee shall be allowed a standard deduction of a sum equal to 30% of the net annual value. As per Sec. 24 interest payable in India on borrowed capital, where the property has been acquired, constructed, repaired, renovated or reconstructed with borrowed capital is allowable as a deduction. Interest amount paid/payable will be deducted. Same will be aggregated first and allowed in five successive financial years starting from the year in which the acquisition/construction was completed. Income from house property is taxable on the basis of annual value. Even if the property is not let out, notional rent receivable is taxable as its annual value Sec. 23(1)(a). In determining the annual value there are four factors which are normally taken into consideration. These are: i) Actual rent received or receivable, ii) Municipal value, iii) Fair rent of the property, iv) Standard rent. Fair rent is the rental value which the property is expected to fetch, depending on the prevailing rents in the neighborhood and other market conditions. Municipal value is the

rateable value of the property determined for the purpose of levy of Municipal taxes. Standard rent is the maximum rent for a property which its owner can legally charge from a tenant, as per the Rent Control Act. The reasonable rent for a property can be said to be the higher of its Municipal value or the fair rental value, but it shall not be, in any case, more than the standard rent for such property. As per Sec. 23(2) (a) & (b) where the property consists of house or part of a house which:- a) is in occupation of the owner for the purposes of his own residence, or b) cannot actually be occupied by the owner 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 house shall be taken to be NIL. For getting deduction of interest of maximum of Rs. 1,50,000, it will be necessary to obtain a certificate from the person to whom such interest is payable specifying the amount of interest payable by the assessee for the purpose of acquisition/construction of property or conversion of whole or any part of the capital borrowed which remains to be repaid as a new loan. As per Sec. 27, the following persons, though not the legal owners of the property, get are deemed to be the owners :

- i) to spouse
- ii) Holder of an impartible estate
- iii) Member of a co-operative society
- iv) Person in possession of property.
- v) Person having right in a property for a period of not less than 12 years.

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### 3.14 GLOSSARY

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**Annual Rental Value:** Inherent capacity of the property to earn income is termed as its “annual value”, and has been defined as the sum for which the property may reasonably be let out.

**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 (MRV)

**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 (FRV).

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### **3.15 SELF ASSESSMENT QUESTIONS**

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**Define ‘Annual Value’. How is it determined ?**

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**What deductions are allowed from the annual value in computing income from house property ?**

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**Write short notes on:**

**i) MRV**

**ii) FRV**

**iii) ERV**

**iv) Unrealised rent**

**Deductions U/S 24b**

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- 
1. Sanjay owns a house property. Municipal value of house: ₹72,000 per annum. Fair rent of house : Rs 66,000 per annum. Standard rent of house: Rs. 60,000 per annum. The house was let out at Rs. 6,000 per month but was sold on 1st January, 2019. Find out income from house property for the assessment year 2020-21.
  2. Nayan owns a house at Indore. Its municipal valuation is ₹24,000. He incurred the following expenses in respect of the house property :  
Municipal tax @ 20%,  
fire insurance premium ₹2,000 and land revenue ₹2,400.  
He took a loan of Rs 25,000 @16% per annum on 1st April, 2010. The whole amount is still unpaid. The house was completed on 1st April 2015. Find out the income from house property for the assessment year 2020-21 in respect of the following options :

- (a) If the house is used by the assessee throughout the previous year for his residential purpose;
- and
- (b) If the house is let-out for residential purposes on monthly rent of Rs 2,000 from 1st April, 2015 to 31st January, 2016 and self-occupied for the remaining period.
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### **3.16 SUGGESTED READINGS**

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- 1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.**
- 2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.**
- 3. V.P. Gaur, D. B. Narang, Puja Ghai and Rajeev Puri: Income Tax Law and Practice: Kalyani Publishers, New Delhi.**
- 4. Income Tax Law & Accounts by Dr. H C Meharotra and Dr S P Goyal: Sahitya Bhawan Publications.**

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**C. NO. : BCG -302**

**UNIT - IV**

**SEMESTER -III**

**LESSON 10-12**

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**GAINS FROM BUSINESS AND PROFESSION**

**STRUCTURE**

- 4.1 Introduction 1**
- 4.2 Deductions allowed u/s 30 to 44A**
- 4.3 Expenses expressly disallowed**
- 4.4 Treatment of depreciation**
- 4.5 Computation of taxable business income**
- 4.6 Computation of professional income**
- 4.7 Summary**
- 4.8 Glossary**
- 4.9 self assessment questions**
- 4.10 Suggested readings**

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## 4.1 INTRODUCTION

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The provisions for computation of Income from Business and Profession are covered under sections 28 to 44D. Section 28 defines the scope of income which can be taxed under this head. Expenses/allowances expressly allowed by the Act are listed under sections 29 to 37, whereas sections 40, 40A and 43B enumerate those expenses which are expressly disallowed while computing taxable income. The most important head of income is the head 'Profits and gains of Business or Profession'. While the provisions of Sections 28 to 44D deal with the method of computing income under head "Profits and Gains of Business or Profession". The meaning of the expression 'Business, has been defined in Section 2(13) of the Income-tax Act. According to this definition, business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. The concept of business presupposes the carrying on of any activity for profit, the definition of business given in the Act does not make it essential for any taxpayer to carry on his activities constituting business for a considerable length of time. In other words, for even a single or isolated transaction entered into with the idea of making profit would be a business within the meaning of the definition given in Section 2(13). The concept of business presupposes the existence of the assessee's intention to make a profit out of his transactions. The object to make profit must be inherent in the transaction although the ultimate result of the transaction may be such that the assessee had to incur loss. Thus, the assessability of profits and gains from business under this head does not in any way depend upon the ultimate outcome of the venture or transaction yielding income or loss. A loss incurred from business is as much assessable under this head as profit which is chargeable to tax. There may be cases where a tax payer may acquire an asset not with the idea of selling it at a profit but to retain it as his own investment. In such cases the profit or gain derived from the sale or other transfer of such an investment would constitute a capital profit which cannot be charged to tax under the head 'income from business or profession'. However, if the same assessee who holds some investments, decides at a later point of time to convert this investment into stock-in-trade and deals with them as part of his business

assets in the normal course of his business, the profit or gain derived from the sale of the same asset in the ordinary course of the business would constitute income assessable under this head. The fact that the asset concerned was originally acquired without the idea of making profit on sale, is immaterial for the purpose of assessment. Thus, the concept of business presupposes an operation consisting substantially of production or sale or purchase and sale or making arrangements for the production, sale etc. of commodities. Thus, an agency which does not involve actual purchases or sale but acting as intermediary would also constitute the carrying on of a business. The definition of business given in Section 2(13) is wide enough to cover every case of transaction entered into with the idea of earning income. The expression 'Profession' has been defined in Section 2(36) of the Act to include any vocation. In the case of a profession, the definition given in the Act is very much inadequate since it does not clearly specify what activities constitute profession and what activities do not. According to the generally accepted principles, the meaning of the term 'profession' involves the concept of an occupation requiring either intellectual skill or manual skill controlled and directed by the intellectual skill of the operator. For instance, an auditor carrying on his practice, the lawyer or a doctor, a painter, an actor, an architect or sculptor, would be persons carrying on a profession and not a business. The common feature in the case of both profession as well as business is that the object of carrying them out is to derive income or to make profit. The process of making the profit would be the main area of difference between the two while the ultimate object is common to both.

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## **4.2 OBJECTIVES**

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After going through the lesson students will be able to

- Understand about the basic terms covers under Gains from Business and Profession comes under the purview of Income Tax Act, 1961.
- Have practical knowledge about the computation of taxable business income and professional income for the purpose of Income Tax Act, 1961.

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### 4.3 DEDUCTIONS ALLOWED U/S 30 TO 44A

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#### **Deductions from Gross Income of Business or Profession [ Section 30 to 44DB]**

Section 29 says that the profits under the head ‘Profits and Gains of Business or Profession’ are calculated in accordance with the provisions contained in Sections 30 to 44DB, which provide for the deductions to be made from the gross income.

These deductions are :

<b>S. No.</b>	<b>Particulars</b>	<b>Sections</b>
1	Rent, rates, taxes, repairs and insurance for building, used for the purpose of the assessee’s business	30
2	Repairs and insurance premium paid in connection with the plant, machinery, furniture etc. used in business or profession	31
3	Depreciation of buildings, machinery, plant or furniture	32
4	Tea Development Account and Reserve for Shipping companies	33AB and 33AC
5	Expenditure on scientific research	35
6	Expenditure on patents and copyrights	35 A
7	Expenditure on know-how	35 AB
8	Expenditure on eligible projects or Schemes	35 AC
9	Expenditure by way of payment to associations and institutions carrying out Rural Development Programme	& 35 CCB
10	Amortisation of certain preliminary expenses	35 D
11	Expenditure on demerger or amalgamation	35 DD
12	Expenditure incurred under voluntary retirement scheme	35 DDA

S. No.	Particulars	Sections
13	Deduction for expenditure on prospecting; etc. for certain minerals	35E
14	<p><b><i>Other Deductions</i></b></p> <ul style="list-style-type: none"> <li>- Insurance premium of Stock-in-trade</li> <li>- Bonus or commission to employees</li> <li>- Interest on borrowed capital</li> <li>- Employer's contribution to provident and other funds</li> <li>- Employer's contribution to the approved gratuity funds</li> <li>- Loss of animals</li> <li>- Bad debts</li> <li>- Transfer of money to special reserve in case of financial institutions only</li> <li>- Expenditure incurred on family planning case of companies only</li> </ul>	36
15	<p><b><i>General Deductions</i></b></p> <p>Any other type of expenses incurred but not covered under- sections 30 to 36</p>	37
16	Buildings partly used for business premises	38
17	Expenses expressly disallowed while computing income under business or profession	40
18	Expenses not allowed to be deducted under certain circumstances	40A
19	Deemed profits	41

	Deductions in case of oil mining concerns	42
	Definitions of certain terms	43
	Certain deductions to be allowed only on actual payments	43B
	Insurance Business Profits	44
	Maintenance of Accounts by certain Professionals	44AA & 44AB

**a. RENT, RATES, TAXES, REPAIRS AND INSURANCE FOR BUILDINGS (SECTION 30).**

A deduction is allowed regarding rent, rates, taxes, repairs and insurance premium paid for the building premises where the assessee is carrying on his own business or profession.

Rent :

- (1) The full amount of rent will be an admissible deduction in case the building premises are taken on rent.
- (2) In case on rent is paid or the assessee owns the business premises, then no deduction shall be allowed because the landlord cannot be a tenant also. If it is so, the assessee will not be taxed for the building income under the head house property.
- (3) If business premises belong to one of the partners of the firm, the rent paid to the landlord – partner shall be an admissible expense of the firm’s business or profession.

**Repairs:**

- (1) incase the assessee is a tenant, and the agreement of rent provides that the tenant will bear the cost of repairs, the amount paid or spent on account of such repairs, is allowed as deduction.

- (2) Otherwise than as a tenant, e.g., the assessee is the owner of the premises, the amount which the assessee spends on repairs will again be allowed as deduction.

#### **Local taxes,etc.**

Any sums paid on account of land revenue, local rates or municipal taxes in respect of the premises used for the assessee's business, if the assessee is the owner of the building, are allowed under this category, in case the building is on rent then such part of these expenses which the assessee is supposed to pay under the contract of rent entered between the landlord and assessee are also allowed.

#### **Insurance premium**

The amount of any premium paid in respect of insurance against risk of damage or destruction on the premises of the assessee used for his business or profession is allowed as expenditure. Insurance may be against fire, earthquake, etc.

Where the assessee has sub-let a part of the premises, the deduction under section 30 will be limited to the difference between the rent paid and the rent received from sub-letting. Section 38 (i) deals with the cases where the part of the house is used for the business purpose and the remaining part for residence of the assessee. In such case the deduction will be limited to that part of the building which is used for the business purpose.

**b. REPAIRS AND INSURANCE OF PLANT, MACHINERY, FURNITURE (Sec. 31):** -Any amount spent on repairs, insurance or hire charges, etc. On Plant, machinery, furniture by a business organisation is allowed as a deduction.

- (i) The amount paid on account of current repairs thereto.

- (ii) The amount of any premium paid in respect of insurance against the risk of damage or destruction thereto.

The plant and machinery and furniture ,etc. on which this destruction is to be claimed must be used for the business of the assessee. The repairs must be in the ordinary course to replace or to compensate the wear and tear of the asset, i.e., to keep the asset in the working order only and these should not be of capital nature.

**c. DEPRECIATION (Sec. 32): -**

Under Section 32 depreciation on assets is allowed as deduction while computing income from business or profession. To claim this deduction following conditions should be satisfied :

- 1) Assessee should be owner of the asset.
- 2) Asset must be used for the business.
- 3) Such use must be in the previous year.

Depreciation is allowed not on individual asset items, but on block of assets under following categories:

- 1) Buildings
- 2) Plant & Machinery
- 3) Furniture
- 4) Intangible Assets acquired after March 31, 1998 such as know how, Patents, Trademarks, licenses, franchises or any other business or commercial rights of similar nature. The term plant includes ships, vehicles, books, scientific apparatus and surgical equipments used for the business but excludes tea bushes or live stock. If any asset falling in block of assets is acquired during the year and put to use during the

previous year for less than 180 days depreciation on such asset shall be restricted to 50% of the normal depreciation. No depreciation is allowed on motor car which is manufactured outside India and acquired on or after 28<sup>th</sup> of February 1975 but before 1<sup>st</sup> April 2001. However, this restriction does not apply if:

- 1) Assessee carries on a business of running the car on the hire for tourist, or
- 2) If assessee is using the car outside India for his business in another country. If business is carried on in a building not owned by the assessee but acquired on lease or any other occupancy right and any capital expenditure is incurred by him in respect of this building, such expenditure will be considered as cost of asset as if he is the owner of such property.

A. METHOD OF CALCULATING DEPRECIATION

1. Consider total W.D.V. of assets falling in a particular block of assets at the beginning of the year.
  2. Add cost of assets purchased during the previous year.
  3. Deduct Sale Price (or Scrap value) of asset sold, discarded, demolished or destroyed during the year.
  4. On the balance amount i.e. 1+2-3, calculate depreciation at the given rate. If WDV becomes negative, no depreciation is allowed. If all assets in the block are sold depreciation is not allowed even if block has any balance WDV.
- B. In the first year if asset acquired is used for less than 180 days depreciation is restricted to 50% of normal depreciation.
- C. W.e.f. A.Y. 1998-99 an undertaking engaged in generation / distribution of power has an option to claim depreciation on Straight Line Method. Once option is exercised it will apply to all subsequent years.

### **Additional depreciation [ Section 32 (1) (iiA)]**

With effect from assessment year 2006-07 an additional depreciation @ 20% of actual cost of P&M is allowed if following conditions are fulfilled:

- (a) The assessee is engaged in the business of manufacture or production of any article or thing or goods.
- (b) In case any new plant and machinery is acquired and installed on or after 1-04-2005 , it shall qualify for additional / intial depreciation. In case new plant and machinery is acquired before 1-04-2005 but installed on or after 1-4-2005 , then additional depreciation is not available.
- (c) It is allowed in addition to normal depreciation and shall be taken into consideration for calculating written down value.
- (d) To claim additional depreciation @ 20 % of actual cost the condition of use for 180 days during the relevant previous year shall be applicable for this depreciation also. If used for less than 180 days in the previous year in which it is acquired, additional depreciation shall be allowed @ 10 % ( i.e., for half year and remaining 10 % additional depreciation shall be allowed in the next previous year.
- (e) The plant and machinery is new and it has not been used earlier either in India or outside India.
- (f) The plant and machinery is not eligible to be written off @ 100 % of its actual cost in any one previous year.
- (g) The plant and machinery is not in the nature of office appliances or road transport vehicles.
- (h) The return of income must be accompanied by the details of plant and machinery and expansion of installed capacity.

The return of income must be accompanied by a report by the chartered accountant that the deduction has been correctly claimed.

Additional depreciation is not allowed in case of following assets:

- (i) Ships and aircrafts
- (ii) Old plant and machinery used either in India or outside India by any other person.
- (iii) Any plant and machinery installed in office premises, residential accommodation and guest house.
- (iv) Office appliances or road transport vehicles.
- (v) Any other plant and machinery the whole of cost of which is going to be debited to this profit and loss account by way of depreciation or otherwise in any one previous year.

#### **Grant of additional depreciation in succeeding previous year**

In case new plant and machinery is put to use for less than 180 days in the previous year or its acquisition and installation, then additional depreciation shall also be allowed only upto 50 % i.e., 50 % of 35 % in that year and balance 50 % will be allowed in the immediate succeeding previous year.

#### **UNABSORBED DEPRECIATION SECTION 32 (2)**

If profit for the year is not sufficient to absorb depreciation either fully or partially, unabsorbed depreciation can be deducted from any other head of income. If it still remains unabsorbed it can be carried forward to subsequent assessment years to be adjusted against future taxable income. It can be carried forward for unlimited period.

The unabsorbed depreciation can be adjusted in the following manner:

- (1) depreciation allowance is deductible out of profits and gains of the business or profession for that assessment year.
- (2) If any portion of depreciation remains unadjusted it will be set off from any other income of the year except income from other sources.
- (3) Depreciation which remains unadjusted as either there is no income or less income in the relevant previous year, it can be carried forward till it is fully adjusted from any income except salary income during the succeeding previous years. It shall be treated as depreciation for such succeeding previous year.

For setting off brought forward depreciation allowance, following order should be followed :

- (i) firstly depreciation of current year
- (ii) secondly, brought forward business loss/ speculation loss
- (iii) thirdly, brought forward unabsorbed depreciation.

**e. Tea/Coffee/Rubber Development Account (Section 33AB)**

With effect from the assessment year 1991-92, the substituted Section 33AB is applicable to an assessee carrying on the business of growing and manufacturing tea in India. For claiming the deduction u/s 33AB the assessee has to satisfy the following conditions:

**(1) Deposit of amount :**

Where an assessee, carrying on business of growing and manufacturing tea or coffee or rubber in India has, before the expiry of six months from the end of the previous year or before the due date of furnishing the return of his income, whichever is earlier :

- (a) Deposited with the National Bank any amount or amounts in an account (hereinafter in this section referred to as the special account) maintained by the assessee with the Bank in accordance with and for the purposes specified in a scheme (hereafter in this section referred to as the scheme) approved in this behalf by the Tea Board of India or the Coffee Board of India or the Rubber Board.
- (b) Amount of Deduction:
  - (a) a sum equal to the amount or the aggregate of the amounts so deposited; or
  - (b) Forty per cent of the profits of such business (computed under the head “Profits and gains of business or profession” before making any deduction under Section 33AB), whichever is less.

Special account defined: It is an account to be opened with national bank for agriculture and rural development (NABARD)

This benefit shall also be available if such amount is deposited in an account to be opened in accordance with and for the purpose specified in a scheme framed by the tea, coffee or rubber board with the prior approval of central government. This benefit is to be made available only in relation to assessment years 1995-96 and afterwards.

### **When to deposit**

Amount has to be deposited

- (a) before the expiry of six months from close of previous year; or
- (b) before date of furnishing of return ; which ever is earlier.

### **Withdrawal of amount [ Section 33 AB (3)]**

Withdrawal from this account will not be allowed except on :

- (a) closure of business
- (b) death of assessee
- (c) partition of HUF
- (d) dissolution of firm or
- (e) liquidation of company

in case any amount is withdrawn due to closure of business or dissolution of firm, before 8 succeeding previous years the whole of such amount shall be deemed as income taxable under the head profits and gains of business or profession of the previous year in which amount is withdrawal [ 33AB (5)]

In case any amount is withdrawn and utilized for the business during the previous year and expenditure shall not be debited to profit and loss account of that previous year [ 33 AB (6)]

In case any amount is released by the bank in connection with a scheme approved by bank such amount must be utilized within same previous year. Any amount remaining unutilized is deemed as income taxable under profits and gains of business or profession [ 33AB (7)]

### **Compulsory audit**

In case of an assessee who is not subject to audit under any provision of income tax act, and such assessee wants to claim this deduction ,it must get its accounts audited and the report of such audit must accompany the return [ 33 AB (2)].

### **No deduction**

No deduction shall be allowed in respect of any amount utilized for the purchase of :

- (i) any plant and machinery installed in office premises, residential houses and guest houses,
- (ii) any office appliances except computers
- (iii) Any plant and machinery whose full actual cost has been allowed as deduction
- (iv) any new plant and machinery installed for production of an article specified in 11<sup>th</sup> schedule [ 33 AB (4)]

### **Deemed profit**

In case an asset acquired under this scheme is sold/ transferred before expiry of 8 previous years, the amount of cost which was met out, amount released from special account shall be deemed to be profit and gain from the business [ 33 AB (8)]

### **Expenditure incurred in the field of scientific research [ Section 35]**

Section 43 (4) defines the scientific research as activities for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries

References to expenditure incurred on scientific research includes all expenditures incurred for the prosecution , or the provision of facilities for pursuing the scientific research, but does not include any expenditure incurred on the acquisition of rights in or arising out of scientific research. References to scientific research related to a business or class of business include:

- (a) Any scientific research which may lead to or facilitate an extension of that business or, as the case may be, all business of that class;
- (b) Any scientific research of a medical nature and which has a special relation to the welfare of workers employed in that business or as the case may be, all businesses of that class.

All expenses incurred by assessee on promotion of research can be divided into two broad categories.

- (A) Expenses on research carried on by the assessee himself. ( In house research).
- (B) Research activities carried on by an outside agency or body and the assessee helps such a body through finance.

Broadly, expenditure on scientific research can be divided in the following two categories:

**Expenditure on scientific research**

<b>On research carried on by assessee himself</b>	<b>On research carried on by outsiders</b>
<p><b>A-1</b> For all assessee except those covered in point A-II</p> <ul style="list-style-type: none"> <li>- Revenue expenditure [section 35 (1)(i)]</li> <li>- Capital expenditure [ Section 35 (2)]</li> </ul> <p><b>A-2</b> Expenditure on in-house research and development by specified companies [sec. 35 (2AB)]</p> <p>Condition: Research must relate to the business of the assessee.</p>	<p><b>B-1</b> Contribution to an approved research association, university, college or other institutions [ section 35(1) (ii) (iii)]</p> <p><b>B -2</b> Contribution to national laboratory [section 35 (2AA)]</p> <p><b>B-3</b> Contribution to an Indian company whose main objective is scientific research and development [sec. 35 (1) (iii)]</p> <p>Condition: Research may or may not be related to the business of the assessee.</p>

Extract from the eleventh schedule ( List of articles or things)

- ✓ Bear, wine and other alcoholic spirits
- ✓ Tobacco and tobacco preparations such as cigar and cheroots, cigarettes, biris, smoking mixtures for pipes and cigarettes chewing tobacco and snuff.
- ✓ Cosmetic and toilet preparations
- ✓ Toothpaste, dental cream, tooth powder and soap
- ✓ Aerated waters in the manufacture of which blended flavouring concentrations in any form are used.
- ✓ Confectionery and chocolates
- ✓ Gramophones, including record players and gramophones records.
- ✓ Projectors
- ✓ Photographic apparatus and goods.
- ✓ Office machines and apparatus such as typewriters, calculating machines, cash registering machines, cheque writing machines, intercom machines and teleprinters.
- ✓ Steel furniture, whether made partly or wholly of steel.
- ✓ Safes, strong boxes, cash and deed boxes and strong room doors.
- ✓ Latex foam sponge and polyurethane foam.
- ✓ Crown corks, or other things of cork, rubber, polythene or any other material.
- ✓ Pilfer proof caps for packaging or other fittings of cork, rubber, polythene or any other material.

**f. EXPENDITURE ON ACQUISITION OF PATENT RIGHTS OR COPYRIGHTS (SECTION 35A)**

Capital expenditure incurred by all assesseees at any time after 28.2.1966 but before 1st April, 1998 for the purpose of acquisition of patent rights or copyrights for the purposes of his business, would be allowed to be amortised over a period of 14 years in equal instalments beginning with the previous year in which such expenditure is incurred or where such expenditure is incurred before the commencement of the business, the fourteen previous years would be calculated from the previous year in which the business commenced. With effect from 1.4.98 depreciation on intangible assets has been introduced. It is charged @25%. In view of this change expenditure under this section need not be amortised if incurred after the given date. However, where the rights became effective in a year prior to the one in which the expenditure is incurred, the deduction would be allowable to the assessee in respect of that period as remains unexpired. In other words, if at the time of acquisition (incurring the expenses) of the patent, say, the patent has already been utilized for 10 years by the assessee, the cost of the patent would be allowed as a deduction in four equal instalments in the remaining four years. In cases where the assessee acquires the patent or copyright at a time when only one year of its life remains, the entire cost of the patent to the assessee would be allowed in the year of acquisition itself.

\ Any instalments of such expenditure incurred before 1-4-98 shall not be left for claiming as deduction during the previous year commencing from the previous year 2011-12 . hence , section 35 A is not applicable w.e.f Previous year 2011-12.

**g. DEDUCTION IN RESPECT OF EXPENDITURE ON KNOW-HOW  
(SECTION 35AB)**

- (a) When technical know how is acquired in any previous year the lump sum consideration paid shall be allowed to be deducted in 6 equal instalments commencing from the previous year in which such consideration is paid.
- (b) in case technical know how acquired was developed in any Indian laboratory , university or institution referred under section 32 A , the consideration paid shall be written off in three equal instalments.

Note: Any instalments of such expenditure incurred before 1-4-98 shall not be for claiming as deduction during the previous year 2000-01 onwards commencing and hence , section 35 A is not applicable w.e.f Previous year 2000- 01.

Note: Any expenditure incurred on acquiring know- how shall qualify for depreciation @ 25 % with effect from 1-4-98.

**Amortization of expenditure for obtaining right to use spectrum for telecommunication services [ Section 35 ABA] [ w.e.f A.Y 2017-18]**

Any capital expenditure incurred and actually paid by an assessee on the acquisition of any right to use spectrum for telecommunication services shall be allowed as a deduction in equal instalments over the period starting from the year in which such payment has been made and ending in the year in which the useful life of spectrum comes to an end.

Expenditure for obtaining licence to operate telecommunication services [ Section 35 AAB]

1. In case any capital expenditure is incurred for acquiring a license to operate telecommunication services and actual payment has been made , a deduction of an amount equal to appropriate fraction

shall be allowed in every previous year during which the license shall be in force.

Appropriate fraction = actual payment made x 1/ Number of previous years for which the fee is paid.

“ Actual payment has been made” means the actual payment of expenditure irrespective of the previous year in which liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.

2. Any expenditure incurred to acquire any right to operate telecommunication services in India before the commencement of business shall be deemed to have been incurred in the method of accounting regularly employed by the assessee.
3. In case the licence is sold and capital sum realized from transfer is less than the expenditure remaining unallowed shall be fully allowed to be debited in the year in which it is sold.
4. In case the capital sum realized is more than the amount of expenditure remaining unallowed, the difference between the money realized and amount remaining unallowed shall be chargeable to tax as income under the head profits and gain of business and profession in the previous year in which license is transferred but it shall not exceed the amount which has been written off so far. In case the license is transferred in the year in which business is not in existence, even then this provisions shall be applicable as if business is in existence.
5. In case license is transferred wholly or in part and capital sum realized is not less than the expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed in

the year in which such license is transferred and in any subsequent previous year.

6. In case any part of the license is sold and money realized is more than the unallowed amount and the excess amount does not exceed the amount allowed so far, such excess shall be taxable as business profit. In case, the amount realized does not exceed the unallowed value, the difference can be written off in remaining number of years.
7. Where under a scheme of demerger, the license is sold by demerged company to resulting Indian Company the sub clauses (2) , (3) and (4) shall not be applicable .

Note: In case deduction of any expenditure is allowed under this section, such asset shall not qualify for depreciation under section 32 (1)

**h. EXPENDITURE ON ELIGIBLE PROJECTS OR SCHEMES (SECTION 35AC)[ Omitted w.e.f A.Y 2018-19]**

Section 35AC has been inserted by Finance (No. 2) Act, 1991 from the assessment year 1992-93 onwards. Under this section an assessee is allowed a deduction in computing profits of business or profession in respect of any expenditure by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme.[ Omitted w.e.f A.Y 2018-19]

**Deduction in respect of capital expenditure incurred on setting up of a specified business [ Sec 35 AD]**

With effect from assessment year 2010-11 , a new deduction u/s 35 AD was introduced to provide incentive to those assesses who sets up new

business units in certain specified areas/ fields. This deduction shall be available if following conditions are satisfied:

1. A unit is set up in specified businesses.
2. Unit of the specified business should be a new one.
3. Books of the assessee are audited.

This new section shall apply in case of following business:

- (i) Setting up and operating a cold chain facilities for specified products on or after 1-4-2009.
- (ii) Setting up and operating a warehousing facilities for storage of agricultural produce on or after 1-4-2009.
- (iii) Laying and operating a cross country natural gas or crude or petroleum oil pipeline network for distribution including storage facilities being an integral part of such network on or after 1-4-2007.
- (iv) Building and operating a hotel of two star or above category anywhere in India on or after 1-4-2010.
- (v) Building and operating a hospital with atleast 100 beds for patients anywhere in India on or after 1-4-2010.
- (vi) Developing and building a housing project for slum redevelopment or rehabilitation scheme framed by central or a state government and notified by board as per guidance as may be prescribed on or after 1-4-2010.
- (vii) Developing and building a housing project under a scheme for affordable housing framed by the central or a state government and notified by board as per guidance as may be prescribed on or after 1-4-2011.

- (viii) Production of fertilizer in India on or after 1-4-2001.
- (ix) Setting up and operating an Inland container depot or a container freight station notified or approved under the customs act, 1962 on or after 1-4-2012.
- (x) Bee- keeping and production of honey and bees wax on or after 1-4-2012.
- (xi) Setting up and operating a warehousing facility for storage or sugar on or after 1-4-2012.
- (xii) Laying and operating a slurry pipeline for the transportation of iron ore or on after 1-4-2014.
- (xiii) setting up and operating a semiconductor wafer fabrication manufacturing unit on or after 1-4-2014 , if such unit is notified by the board in accordance with the prescribed guidelines.
- (xiv) Developing or operating and maintaining or developing , operating and maintaining any infrastructure facility on or after 1-4-2017 , i.e., assessment year 2018-19.

**i. EXPENDITURE BY WAY OF PAYMENT TO ASSOCIATIONS AND INSTITUTIONS FOR CARRYING OUT RURAL DEVELOPMENT PROGRAMMES (SECTION 35CCA)**

Any sum paid to a rural development fund set up and notified by the Central Government and to the National Urban Poverty Eradication Fund similarly set up and notified qualifies for deduction on fulfillment of certain conditions.

**Conditions**

Deductions under this section shall be allowed only if following conditions are also satisfied:

- (i) The assessee has obtained the approval of the prescribed authority in respect of such programme before the 1<sup>st</sup> day of march, 1983
- (ii) such programmes involves work by way of construction of any building or other structure whether for use as dispensary , school , training or welfare centre, workshop or any other purpose or the laying of any road or the construction or boring of a well or tubewell or the installation of any plant and machinery and such work has commenced before the 1<sup>st</sup> day of march, 1983;
- (iii) the expenditure on such programmes is incurred in a case where the approval of the prescribed authority

Amount of deduction : 100 % of the amount contributed.

**Expenditure on notified agricultural extension project [ section 35 CCC]**

- (i) **Eligible assessee:** Any [ i.e., Individual , HUF, Firm, Company, etc.]
- (ii) **Nature of expenditure:** The expenditure must have been incurred on agricultural extension project notified by the board in this behalf in accordance with the prescribed guidelines.
- (iii) **Amount of deduction:** 150 % of such expenditure [ w.e.f assessment year 2021- 22, rate of deduction shall be only 100 %]
- (iv) **No deduction under any other section:** Where such expenditure is claimed and allowed under this section for any assessment year, no deduction shall be allowed in respect of such expenditure under any other provisions of the income tax for the same or any assessment year.

**Expenditure on notified skill development project [ Section 35 CCD]**

- (i) Eligible assessee: Company
- (ii) Nature of expenditure : The expenditure must have been incurred on any skill development project notified by the board in this behalf in accordance with the prescribed guidelines.
- (iii) **Amount of deduction:** 150 % of such expenditure [ w.e.f assessment year 2021- 22, rate of deduction shall be only 100 %]
- (iv) **No deduction under any other section:** Where such expenditure is claimed and allowed under this section for any assessment year, no deduction shall be allowed in respect of such expenditure under any other provisions of the income tax for the same or any assessment year.

**j. AMORTISATION OF PRELIMINARY EXPENSES (SECTION 35D and Rule 6AB]**

Under Section 35D, Indian companies and other non-corporate taxpayers resident in India would be entitled to amortisation of certain preliminary expenses incurred by them at any time after 31.3.1970. The expenditure which qualifies for amortisation should have been incurred by the assessee:

- (i) before the commencement of his business,
- (ii) if however, the expenditure is incurred after the commencement of business, it is essential that the expenditure should be in connection with the extension or expansion of the undertaking of the assessee or in connection with the setting up of a new unit by the assessee.

**Amount of Deduction:**

The amount qualifying for amortisation would be allowable as a deduction in five equal instalments beginning with the previous year in which the business of the assessee actually commences or the previous year in which the extension of the present undertaking is completed or the new unit commences production or operation, as the case may be.

**Qualifying amount of expenses:**

The following items of expenses qualify for amortisation under this section as preliminary expenses:

- (i) expenditure incurred by the assessee in connection with the preparation of feasibility report or project report;
- (ii) expenses for conducting market survey or any other survey necessary for the purpose of the business of the assessee;
- (iii) expenditure for getting engineering services related to the business of the assessee;
- (iv) expenses by way of legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee;
- (v) in the case of a company
  - (a) expenses by way of legal charges for drafting the Memorandum and Articles of Association of the Company;
  - (b) expenses for printing the Memorandum and Articles of Association;
  - (c) expenses by way of fees for registration of the company under Companies Act, and

- (d) expenditure incurred in connection with issue for public subscription of shares or debentures of the
- (vi) company, being underwriting commission, brokerage and the charges of drafting, typing, printing and advertisement of the prospectus; and
- (vii) (vi) such other items of expenses not covered by the list specified above which the Central Board of Direct Taxes may prescribe for the purpose of amortisation under this section.

**k. EXPENDITURE IN THE CASE OF AMALGAMATION/ DEMERGER (SECTION 35DD)**

The section provides that where an assessee, being an Indian company, incurs expenditure on or after April 1, 1999 wholly and exclusively for the purpose of amalgamation or demerger, the assessee shall be allowed a deduction equal to one fifth of such expenditure for five successive previous years beginning with the previous year in which amalgamation or demerger takes place. No deduction shall be allowed in respect of the above expenditure under any other provisions of the Act.

**l. AMORTISATION OF EXPENDITURE IN THE CASE OF VOLUNTARY RETIREMENT SCHEME (SECTION 35DDA)**

The object of this section is to provide amortisation of one-fifth every year from the year in which the expenditure is incurred, of expenditure by way of payment of any sum to an employee in connection with his voluntary retirement. It also provides that no deduction would be allowed in respect of such expenditure under any other provision of the Act.

**m. DEDUCTION IN RESPECT OF EXPENDITURE ON PROSPECTING ETC. FOR CERTAIN MINERALS (SECTION 35E)**

Section 35E of the Income-tax Act provides allowance to amortise the capital expenditure incurred by an assessee towards prospecting for certain minerals. The benefit of amortisation under this section is available to Indian companies and other non-corporate entities resident in India.

The assessee would not be entitled for amortisation under this section in respect of the following three items of expenses namely,

- (i) Expenditure incurred on the acquisition of the site of the source of any mineral or group of associated minerals or of any right in or over such site.
- (ii) Expenditure on the acquisition of the deposits of such minerals or group of associated minerals or of any right in or over such deposits; or
- (iii) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is available under Section 32 of the Income-tax Act.

**n. DEDUCTION U/S. 36:**

**1. Insurance: Section 36(1)**

- (a) The assessee is entitled to the deduction of the amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession.
- (b) The amount of premium paid by federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society, being a primary

society engaged in supplying milk raised by its members to such federal milk co-operative society.

- (c) The amount of any premium paid by cheque by the assessee as an employer to effect or to keep in force an insurance on the health of his employees under a scheme framed in this behalf by –
  - A. the General Insurance Corporation of India formed under Section 9 of the General Insurance Business (Nationalisation) Act, 1972 and approved by the Central Government; or
  - B. any other insurer and approved by the Insurance Regulatory and Development Authority established under Sub-section (1) of Section 3 of the Insurance Regulatory and Development Act, 1999.
- 2. Bonus or commission paid to Employees: Section 36(1) (ii): It is allowed as deduction so far as they are not paid as profit or dividend.
- 3. Interest on borrowed capital: Section 36(1) (iii): It is allowed as deduction However, interest paid by firm to its partners is allowed subject to provisions of Sections 40(b). Discount on zero coupon bonds is deductible by issuing Company on pro rata Basis Sec.36(1)(iii a)
- 4. Contribution to recognised Provident fund or an approved super annuation fund: Section 36(1)(iv). Any sum paid by the assessee as an employer by way of contribution towards pension scheme.
- 5. Contribution to Pension Scheme: Section 36(1)(iva) Any contribution by an employer by way of contribution towards a pension scheme for an employee up to 10% of salary shall be allowed as deduction.
- 6. Contribution to approved Gratuity Fund Section 36(1)(v): Amount contributed to the fund which is for the exclusive benefit of the employees will be allowed as deduction. Contributions received from employees (when deposited) Section 36(1)(va): Any contribution received

from employees towards any funds for the welfare of the employees e.g. P. F. will be allowed as deduction when such contribution is credited to employees a/c on or before the due date. It is allowed as deduction not because it is an expenditure of the assessee. In fact, it is not at all an expenditure of the assessee. But when this amount is deducted from salary of employees, it is treated as an income under section 2(24)(x). Therefore, deduction is allowed when payment is made by the due date.

7. Animals used for the business: Section 36 (1) (vi): Deduction is allowed when animals have died or have become permanently use less. Amount of deduction will be difference between actual cost of the animals and amount realised if any in respect of carcasses of the animals. Deduction is allowed only if animals are used for the purpose of business but not as stock in trade.
8. Bad debts: Section 36(1)(vii) and Section 36(2): Deduction is allowed on this account if debts have arisen out of business transaction. It is the responsibility of the assessee to prove to the satisfaction of income tax officer that such debts are irrecoverable.
9. Expenditure for promoting family planning: Section 36(1)(ix): Only a company can claim this deduction. Any expenditure incurred by a company to promote family planning among its employees is allowed as deduction fully, provided it is revenue expenditure. Any capital expenditure on this account is allowed as deduction in 5 equal instalments. If profit is not sufficient to absorb this expenditure it can be carried forward to be set off in future. No depreciation can be claimed under section 32 on capital assets used for promoting family planning and allowed as deduction under section 36(1)(ix).

**o. GENERAL EXPENDITURE FOR THE PURPOSE OF BUSINESS OR PROFESSION SECTION 37:**

Section 37 (1) Says that any expenditure ( not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital

expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head, “Profits and Gains of Business or Profession”.

The deduction are to be allowed in respect of those expenses which shall satisfy the following conditions:

1. The expenditure should not be of the type of expenses already covered under sections 30 to 36 of this act.
2. Expenses should have been incurred in the relevant accounting year.
3. Expenses should be in respect of the business carried on by the assessee and the profits of which are to be computed and assessed, and should be incurred after the business is set up.
4. Expenses should not be in the nature of personal expenses of the assessee.
5. The expenses should have been incurred totally and exclusively for the purposes of the business of the assessee.
6. Expenses are not of capital nature.
7. The expenses are incidental to the business of the assessee and directly spring from the carrying of it.

#### **Allowable deductions u/s 37 (1)**

The following are some of the examples of expenses allowable as deduction u/s 37:

1. All expenses and payments made for purchasing of raw materials, manufacture and sale of goods.

2. All expenses in the nature of advertisement to push up sales.
3. Sales tax and expenses incurred in relation to sales tax appeal
4. Day to day expenses to carry on business.
5. Some subscription to be paid compulsorily and to protect the business interests.
6. Reasonable expenses incurred on Diwali /Puja or other festivals, etc.
7. Reasonable expenses incurred at the time of mahurat, dewali, etc. but no monetary ceiling has been fixed by board.
8. Royalty paid in connection with the use of trade marks, patents, copyrights, etc.
9. Commission paid to procure orders.
10. Compensation paid to an agent in connection with the termination or modifications in the terms and conditions of his agency.
11. Installation expenses of new telephone and payment made under 'Own Your Telephone' (OYT scheme).
12. Expenses incurred to oppose the threatened nationalization of the business.
13. Legal expenses incurred to claim damages or compensation in case of non- fulfillment of a contract.
14. Pension, Gratuity and any other voluntary payment given to the employees.
15. Gifts given to the employees but such gifts should not fall in the category of perquisites.

16. Bonus paid on the basis of an industrial award.
17. Any compensation paid to an employee on the termination of his service and also compensation paid to a managing agent on the termination of his agency.
18. Insurance premium paid to get insurance of employees against injury, accident while working and also any compensation paid to employees due to such injury or accident. Payment received from insurance company, if any, shall be treated as taxable income and credited to p/l a/c.
19. Expenses incurred on employees welfare activities.
20. Embezzlement by an employee during the normal course of the business.
21. Any payment given by the assessee to business rivals agreeing not to compete with the assessee.
22. Any compensation payable in the usual course of business including compensation paid as a result of negligence of the assessee of the assessee or his employees.
23. Amount paid to the preserve and protect business assets, interest and reputation.
24. Amount spent or preserve and protect business assets, interest and reputation.
25. Amount spent or payable to the govt. in case of short fall in the export target.

**Illustrations of losses which are treated as business losses**

1. loss by theft and embezzlement by employee

2. loss of cash due to robbery while being carried by cashier for disbursement.
3. Loss of cash by dacoity in case of a banking company.
4. Brokerage, commission and stamp duty incurred on rent deed for hiring office premises.
5. Loss due to accidental fire in stock in trade.
6. Loss caused by white ants.
7. Loss caused due to theft of pledged goods.
8. Loss on sale of securities held by assessee as a trading asset.
9. Loss due to fire of hired machinery.
10. Loss of stock in trade due to enemy action.
11. Loss of stock due to natural calamities.
12. Loss due to non- realization of amount given as advance for purchases in the usual course of business.
13. Loss due to fluctuations in the rate of foreign currency.
14. Loss due to breach of contract.
15. Loss due to non- acceptance of delivery of goods.

Illustrations of losses which are not treated as business losses

1. Any loss which is not incidental to carrying on the business such as withdrawal of cash from bank by a forged cheque and then if cash is misappropriated by the employee.
2. Loss incurred on transfer of business assets.

3. Loss incurred due to sale of shares or securities held by the assessee
4. Loss incurred due to closure of business.
5. Loss suffered due to infringement of any law of the land.
6. Any loss which the assessee is likely to suffer in future years.
7. Any loss which does not belong to the current previous year i.e, past losses.

**p. DEEMED PROFITS (SECTION 41)**

Section 41 of the Income-tax Act enumerates items of notional income which are deemed to be income from business or profession chargeable to tax. The liability to tax in respect of deemed profits would arise not only during the existence of the business but also after its discontinuance. The items of deemed profits are enlisted below:

- (i) Deduction allowed earlier but recovered later on: [Section 41 (1)]. The finance act , 1992 has submitted the sub- section 41 (i) by the following with effect from assessment year 1993-94.

Where any allowance or deduction has been made in the assessment for any year in respect of losses, expenditure or trading liability incurred by the assessee and subsequently during any previous year.

The first mentioned person has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to tax as the income of that previous year whether the

business or profession in respect of which the allowance or deduction has been made, is in existence in that year or not.

In case such benefit or cash is obtained by successor in business in manner whatsoever in respect of which loss or expenditure was incurred by first mentioned person the provisions mentioned above shall be applicable against such successor in business and he shall be liable to pay tax on such deemed profit.

The words successor in business means:

In case of amalgamation – the amalgamated company.

In case of succession – the successor.

In case of a firm is succeeded by another firm, such other firm.

- (ii) Where any building, machinery plant or furniture owned by the assessee and used for the purpose of business for which depreciation under Section 32(1)(i) is claimed, is sold, discarded, demolished or destroyed and the money payable together with scrap value in respect of such assets exceeds the written down value, the excess to the extent of difference between the actual cost and the written down value shall be taxable as business income in the previous year in which the moneys payable become due.
- (iii) Capital expenditure on Scientific Research: Where an assessee incurs capital expenditure on scientific research, the entire amount of such expenditure is allowable as a deduction in computing the business income of the assessee in the same year in which the expenditure is incurred. If subsequent to the incurring of the expenditure, the asset representing the capital expenditure is sold, without having been used for other purposes, the assessee would be liable to pay tax on the excess of sale proceed together with the

deduction allowed earlier over the amount of capital expenditure or the amount of deduction allowed earlier whichever is less.

- (iv) **Recovery of Bad Debts:** Where the assessee claims a deduction in any year in respect of a debt which has become bad or irrecoverable and the Assessing Officer allows a deduction to the extent of the bad debts.
- (v) **Withdrawal of any amount from special reserve:** Where a deduction has been allowed in respect of any special reserve created and maintained under clauses (viii) of Sub-section (1) of Section 36 any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income tax as the income of the previous year in which such amount is withdrawn.
- (vi) **Setting off loss from deemed profit [ section 41(5)]:** Any loss of a business incurred during the year in which it ceased to exist and which could not be set off against any other income of that previous year shall be set off against the above mentioned deemed incomes. This does not apply to speculation loss.

**q. SPECIAL PROVISION FOR DEDUCTIONS IN THE CASE OF BUSINESS FOR PROSPECTING ETC. FOR MINERAL OIL (SECTION 42)**

For the purpose of computing the profits and gains of any business of prospecting for or the extraction or production of mineral oils in relation to which the Central Government has entered into an agreement with any person for the association or participation in such business of the Central Government, the assessee is entitled to an allowance over and above the various items of allowances and deductions permissible under the IncomeTax Act.

**r. DEFINITION OF CERTAIN TERMS (43)**

**Deduction of certain payments only if actually paid [ section 43 B]**

any payment of sales tax, employer's contribution to any provident fund, superannuation fund or gratuity fund, or any other fund for the welfare of employees will be allowed only in computing the income of that previous year in which such sum is actually paid by him. In case a deduction has already been claimed on accrual basis in any earlier previous year, it will not be allowed again in the year in which it is actually paid.

These payments are:

- (1) Any sum payable by the assessee by way of tax, duty, cess or fee by whatever name called , under any law for the time being in force.
- (2) Any sum payable by the assessee as an employer by way of contribution of any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees.
- (3) Any sum referred to in clause (ii) of sub section (1) of section 36, i.e., bonus or commission payables to employees.
- (4) Any sum payable by assessee as interest on any loan or borrowing from any public financial institution or a state financial corporation or a state industrial investment corporation in accordance with the terms and conditions governing such loans or borrowing . deduction regarding these payments shall be allowed if such payments are actually made before filing of return u/s 139 (1).
- (5) Any sum payable by the assessee as interest on any term from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan.

- (6) Any amount payable by the assessee to the Indian railways for the use of railway assets.
- (7) Payment of interest to a co-operative bank to be allowed as deduction on actual payment basis. Co-operative bank excludes a primary agricultural credit society or a primary co-operative agricultural and rural development bank [ w.e.f AY 2018-19]
- (8) Any amount payable by the assessee as an employer in lieu of any leave at the credit of employee shall be allowed to be debited only if it is made in accordance with the provisions of section 43 B.

U/s 43 B provisions , the above payments shall be allowed in following manner:

1. If all these provisions, as mentioned above, are actually paid by the end of the previous year i.e., 31<sup>st</sup> march, such payments shall be fully allowed.
2. If payments as mentioned above at (2) above of provident fund or employees state insurance contribution is paid before due date prescribed under P.F act or ESI corporation act, such payment shall be fully allowed. In case, these payments are made after due date, these shall never be allowed.
3. If all the above payments are paid after 31<sup>st</sup> March but before prescribed date of filing of return, it shall be allowed to be debited in the year to which these payments belong. If it paid after prescribed date, the payment shall be allowed to be debited in the year in which payment is made.
4. In case payments as mentioned above are made by cheque, the proof of their encashment must be submitted within 15 days from the due date / prescribed date.

## **SPECIAL PROVISION FOR COMPUTATION OF COST OF ACQUISITION OF CERTAIN ASSETS (SECTION 43C)**

Where an asset [other than those referred to in Section 45(2)] which becomes the property of an amalgamated company under a scheme of amalgamation, is sold after February 29, 1988 as stock in trade the cost of acquisition of the asset to the amalgamated company shall be the cost of acquisition of the asset to the amalgamating company as increased by the cost, if any, of any improvement made thereto and the expenditure if any, incurred wholly and exclusively in connection with such transfer.

### **Valuation of consideration on sale of immovable property held as stock in trade at a price below stamp value [ Section 43 CA]**

If 105 % of the sale consideration for transfer of land and building held as stock in trade is less than the stamp duty value, such stamp duty value shall be considered as full value of consideration for the purposes of computing income U/H ‘ Income from Business or Profession’[ Section 43 CA (1)].

Where the date of agreement and the date of registration of transfer are different , stamp duty value on the date of agreement may be considered provided full or partial consideration has been received by way of an account payee cheque or an account payee draft or by use of electronic clearing system through a bank account. [ W.e.f.A.Y 2019-20] on or before the date of agreement [ Section 43 CA (3) & (4)].

Computation of income from construction or service contracts. [ Insertion of section 43 CB in A.Y 2019- 20] [ w.r.e.f A.Y 2017-18].

1. Profits and gains from construction contract shall be computed by applying percentage of completion method .

2. Profits and gains from service contracts to be determined by applying percentage of completion method with following exceptions.
- If the project duration is upto or more than 90 days, project completion method to be used.
  - If the project involves indeterminate number of acts over a specific period of time, straight line method would have to be used.

**SPECIAL PROVISION IN CASE OF INCOME OF PUBLIC FINANCIAL INSTITUTIONS, ETC. (SECTION 43D)**

Section 43D has been inserted by Finance (No. 2) Act, 1991 w.e.f. 1.4.1991. This section provides that in the case of a public financial institution or a scheduled bank or a state financial corporation or a state industrial investment corporation, the income by way of interest on such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts shall be chargeable to tax in the previous year in which it is credited to profit and loss account by such institution referred above for that year or in the previous year in which it is actually received by them whichever is earlier.

**Taxation of foreign exchange fluctuations [ Insertion of Section 43 AA] [ w.r.e.f A.Y 2017-18]**

Subject to the provisions of section 43 A , any gain or loss arising on account of any change in forgin exchange rates shall be treated as income or loss, as the case may be , and such gain or loss shall be computed in accordance with the income computation and disclosure standards notified under section 145 (2).

**s. INSURANCE BUSINESS (SECTION 44)**

The profits and gains of any business of insurance must, according to Section 44, be computed in accordance with the rules contained in the First Schedule to the Income-tax Act. For the purpose of the computation, it is immaterial whether the insurance business is carried on by mutual insurance company or by a co-operative society or by any other person. The rules contained in the Schedule would apply notwithstanding anything to the contrary contained in the provisions of the Income-tax Act relating to the computation of income chargeable under the head 'Interest on Securities', 'income from house property', 'capital gains', or 'income from other sources' or under the head 'income from business or profession'.

**t. SPECIAL PROVISIONS FOR DEDUCTION IN CASE OF TRADE, PROFESSIONAL OR SIMILAR ASSOCIATIONS (SECTION 44A)**

Section 44A of the Income-tax Act provides for a special deduction in the case of any trade, professional or similar association which is not exempt from Income-tax under Section 10(23A). This deduction is allowable in cases where the amount received during the accounting year by the trade, professional or other associations from its members, whether by way of subscription or otherwise, falls short of the expenditure actually incurred by such association during that accounting year solely for the purpose of protection or advancement of the common interest of the members. Moneys received by way of remuneration for running any specific services to the members would not, however, be treated as forming part of income of the association for this purpose. Consequently, in calculating the amount of deficiency, these receipts would be taken into account and would be allowed as deduction so as to reduce the amount of deficiency. Similarly, capital expenditure and also expenditure deductible in computing the income of the assessee under any other

provision of the Act, would not be taken into account in determining the amount of deficiency. The amount of deficiency would be allowable as a deduction in computing the income of the association assessable for the relevant assessment year under the head 'profits and gains from business or profession'. If there is no income assessable under this head or the amount of deficiency allowable to the assessee exceeds the income under this head, the whole or the balance of the amount of deficiency, as the case may be, shall be allowed as a deduction in computing the income of the association assessable for that assessment year under any other head. The amount of deficiency shall not, however, be allowed to be carried forward for any subsequent year. The amount of deficiency to be allowed as deduction under Section 44A should not, in any case, exceed 50% of the total income of the association computed before making any allowance under this section. This section, however, applies only to that trade, professional or other similar associations, the income of which or any part thereof is not distributed to its members except as grants to any institution or association affiliated to it. In computing the income of the association for the relevant assessment year in which the deficiency falls allowable, the other provisions of the Act granting deductions and allowances must be given effect to before the deficiency under this section could be allowed. Likewise, losses from any earlier year which are brought forward and qualify for being set off, must be allowed to be set off before the deficiency under this section is sought to be allowed as deduction.

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#### **4.4 EXPENSES EXPRESSLY DISALLOWED WHILE COMPUTING GAINS FROM BUSINESS AND PROFESSION**

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Following amounts shall not be deducted while computing income under the head Profits & gains of business or profession.

1. Interest, royalty, fees for technical services etc payable to a non-resident or outside India without deducting TDS & its payment;

2. Interest, commission or brokerage,
3. fees for professional services or fees for technical services payable to any resident person without TDS & its payment.
4. Fringe Benefit Tax;
5. Income-tax;
6. Wealth-tax;
7. Any payment which is chargeable under the head “Salaries”, if it is payable outside India, or to a non-resident, and the tax has neither been paid in India nor deducted there from;
8. Any payment to a provident fund or any other fund established for the benefit of employees of the assessee in respect of whom the assessee has not made effective arrangement to secure that tax shall be deducted at source from any payment made from the fund, which are taxable under the head ‘Salaries’; and
9. Any tax on non-monetary perquisite actually paid by employer on behalf of employee.
10. 40A(2): Any payment made by an assessee to a related person shall be disallowed to the extent it is excess or unreasonable as per the Assessing Officer. Related person includes both “Relative” and “Person having substantial interest”
11. 40A(3) Where any expenditure in respect of which payment is made in excess of Rs.20000 at a time otherwise than by a payee cheque or draft, 100% of such payment shall be disallowed.
12. No deduction shall be allowed in respect of any provision made by assessee for the payment of gratuity to his employees provided such contribution is

not towards an approved gratuity fund or for the purpose of payment of gratuity, that has become payable during the previous year.

13. No deduction shall be allowed in respect of any sum paid by the assessee as an employer towards setting up or formation of, or as contribution to, any fund, trust, company, AOP, BOI, society or other institution for any purpose provided such sum is not by way of contribution towards approved superannuation fund, recognised provident fund, approved gratuity fund.

Deduction in respect of following expenses are allowed only if payment is made on or before the due date for furnishing return of income –

14. section 43A - following sum not paid before due date of filing return of income
  1. Any sum payable by way of tax, duty, cess, fee, etc.
  2. Bonus or commission to employees.
  3. Interest on loan or borrowing from any public financial institutions, etc.
  4. Interest on any loans and advances from a scheduled bank.
  5. Leave encashment.
  6. Contribution to any P.F., superannuation fund, gratuity fund, etc.

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#### **4.5 TREATMENT OF DEPRECIATION**

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##### Depreciation (Section 32)

In computing income from business, one of the most important items of allowances is the allowance for depreciation provided by Section 32 of the Income-tax Act. The deduction towards depreciation is very essential to arrive at the income of the assessee and also to amortise the capital cost of the amount invested in buildings, machinery, plant and furniture. The purpose of allowing

depreciation is to provide in course of time for the replacement of asset with the help of the capital cost of the asset which is allowed to be amortised over a period of time. The provisions for allowing depreciation are contained in Section 32 and are regulated under Rule 5 of the Income-tax Rules. The rates of depreciation are also provided in the Income-tax Rules.

**(a) Classification of Assets:**

The assets in respect of which depreciation is claimed must be buildings, machinery, plant or furniture. In addition to these tangible assets intangible assets like know how, patent rights, copy rights, trade marks, licences, franchises or any other business or commercial right of similar nature acquired on or after 1.4.1998 are eligible for depreciation. These intangible assets will form a separate block of assets. As and when any capital expenditure is incurred by an assessee on acquiring such intangible assets, the amount of such expenditure will be added to the block of intangible assets and depreciation will be claimed on the written down value at the end of financial year. While taking into account the depreciation allowance in respect of a building, only the cost of the building is to be taken into account but not the cost of the land on which the building is erected because the land does not suffer any depreciation as a result of wear and tear or its usage. Thus, the term building used in this context refers only to the super-structure and not the land on which it is erected. Roads within a factory compound form part of building which is used for the purpose of the business and as such are entitled to depreciation. Similarly, residential quarters provided to the employees are used for the business in the sense that they are used for and such user is incidental to the carrying on the business. Therefore, the roads to such residential quarters are also entitled to depreciation at the rates applicable to first class building.

## **Plant**

The term 'plant' for the purpose of allowance of depreciation has been defined in Section 43(3) to include ships, vehicles, books, scientific apparatus and surgical equipments used for the purposes of the business or profession. However, on the basis of cases decided by the courts, the following are also included in the term 'plant':

- (i) In the case of a hotel, pipe and sanitary fittings
- (ii) (ii) In the case of electric supply company, mains service lines and switch gears

However, following are some of the instances which are not held as plant:

1. Warehouses for storage purposes
2. Horses
3. Human body
4. Bed of River
5. Water storage tanks used for storing water by the supplier for irrigation purposes.
6. Cinema Theaters
7. Hotel Building

Moreover, 'tea bushes', 'livestock', buildings or furniture and fittings have been excluded from the definition of plant.

### **(b) Ownership Vs. lease:**

Depreciation is allowable to the assessee only in respect of those capital assets which are owned by him. In case of a building, the assessee must be owner of the super-structure and not necessarily of the land on which

it is constructed. If the assessee is only a tenant of the building but not its owner he is not entitled for allowance in respect of depreciation thereof. Where the land on which the building is constructed has been taken on lease by the assessee, the allowance of depreciation would be admissible only if, according to the lease deed, the assessee is entitled to be the owner of the super-structure. The fact that as part of the terms of the lease deed, the building, after expiry of the lease is to be transferred to the lessor of the land would not affect the allowance for depreciation. In the case of assets acquired on hire-purchase e.g., plant and machinery taken on hire, the assessee would not be the owner thereof and consequently would not be entitled for depreciation in respect of the same. But if the plant and machinery had been acquired on instalment basis, the assessee becomes the owner of the assets the moment the purchase or sale is concluded and consequently is entitled to depreciation although a part or whole of the price is payable in future.

**(c) Used for the purpose of Business or Profession:**

The allowance for depreciation is subject to the condition that the assets on which depreciation is claimed are actually used by the assessee for the purposes of his business or profession during the accounting year. The allowance for depreciation, however, is not subject to the condition that the asset in question must be used throughout the relevant accounting year in order to enable the assessee to claim depreciation. Thus, even if the asset is used for a very small fraction of the accounting year, the assessee would be entitled to depreciation in respect of the full amount allowable as if the asset had been used throughout the accounting year. Even in the case of seasonal factories (e.g., sugar manufacturing companies), the full amount of depreciation is allowable if the asset had been used at any time during the accounting year in the factory. In cases where the depreciable asset is used partly for business purposes and partly for other purposes, the deduction towards depreciation allowable under

Section 32 would be of a sum proportionate to the depreciation allowance to which the assessee would have otherwise been entitled, in the year in which the depreciable asset is sold, destroyed, discarded or demolished, no depreciation at the rates

prescribed in the Income-tax Rules would be allowable.

- (d) Amount of deduction shall not exceed actual cost: The total amount of all items of depreciation allowance allowed to the assessee from year to year shall not exceed the actual cost of the block of assets to the assessee.
- (e) No deduction on sold assets: No depreciation is allowable in respect of the depreciable asset if the asset concerned is sold, destroyed, discarded or demolished in the same year in which it was acquired.
- (f) In order to be entitled to allowance towards depreciation, the assessee must furnish the prescribed particulars contained in Annexure 'B' attached to the Form of the Return of Income-tax. Any failure on the part of the assessee to furnish fully and truly all material facts, including the particulars prescribed for this purpose, would entitle the income-tax authorities to refuse to allow deduction towards depreciation.
- (g) The Finance Act, 1995 has deleted w.e.f. assessment year 1996-97 the provision pursuant to which one could write off the entire cost of plant and machinery in the very first previous year in which it was put to use provided its actual cost did not exceed ' 5,000, to prevent the widespread misuse of the concession.
- (h) The Finance (No. 2) Act, 1996 has rationalised the depreciation provisions, inter alia as follows:

In case of joint ownership of an asset, depreciation would be allowed to each of the owner in proportion to the contribution to the total cost of the asset; and In case of amalgamation during the course of a previous year,

the amalgamating company and the amalgamated company shall share the depreciation in proportion to the number of days during which assets remained under their respective ownership. Similarly, in case of demerger during the course of a previous year (w.e.f. 1.4.2000), the demerged company and the resulting company shall share the depreciation in proportion to the number of days during which the assets remained under their respective ownership.

### **Meaning of Block of Assets**

The depreciation is provided in respect of “Block of assets”. As per Section 2(11) Block of assets means “a group of assets falling within a class of assets, being tangible assets such as buildings, machinery, plant or furniture and intangible assets, being know-how, patents, copyrights, trademarks, licences, Franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed”.

Moreover depreciation is now allowed on the written down value of all types of assets. Again, no deduction shall be allowed under this clause in respect of any motor car manufactured outside India, where such motor car is acquired by the assessee after the 28th day of February, 1975, and is used otherwise than in a business of running it on hire for tourists or,

- (a) outside India in his business or profession in another country, and
- (b) in respect of any machinery or plant if the actual cost thereof is allowed as a deduction in one or more years under an agreement entered into by the Central Government under Section 42 of the Act.

### **Important Terms**

For the purposes of depreciation, the following terms are important:

- (i) Actual Cost

- (ii) Written Down Value
- (iii) Classification of Depreciation
- (i) Actual Cost [Section 43(1)]

For computing depreciation, actual cost is the basis in the case of all assets for the first year when the assets are put to use for the purpose of the business. Subsequently, even in the case of depreciable asset when the written down value is to be ascertained for the purpose of allowing depreciation, the written down value should be taken to be the book value of the asset after allowing deduction in respect of the depreciation allowable under the Income-tax Act from the actual cost of the asset concerned. The actual cost of an asset is essential for the purposes of allowing depreciation also because of the fact that the aggregate of all the items of depreciation allowable to an assessee in respect of any depreciable asset shall not exceed the amount of its actual cost. The actual cost of an asset to the assessee is normally the amount of capital expenditure incurred in respect of the acquisition, installation, etc., of the asset and also the expenses, if any, incurred by him to make the asset ready for the purpose of its use in the business. Thus, capital expenditure relating to the installation of machinery or plant, its design, etc., would form part of the actual cost of the machinery although such expenses may be incurred by the assessee subsequent to the date of its acquisition. It has been held that preliminary expenses of revenue nature necessary for putting plant and machinery in working condition are part of actual cost of plant and machinery.

#### **Definition of Actual Cost**

The expression 'actual cost' has been defined in Section 43(1) of the Act to mean that actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly

by any other person or authority. For instance, if an assessee gets a subsidy from the Government for the purchase of a particular item of machinery, the actual cost of the machinery to the assessee would be total of the purchase price and the expenses in regard to installation etc. minus the subsidy received from the Government. However, where any amount has been received as compensation for low output of defective machinery, it will be a revenue receipt and assessed to tax but it will not be deducted in computing actual cost of machinery.

Thus, the actual cost of the asset as shown in the books will be different from the actual cost on the basis of which depreciation is allowable. The provisions of Section 43(1) of the Act clarify that the actual cost of depreciable.

The provisions of Section 43(1) of the Act clarify that the actual cost of depreciable asset should be determined in the following circumstances as indicated below:

- (a) Assets used in business after it ceases to be used for Scientific Research  
In cases where the depreciable asset is used for the business after it ceases to be used for scientific research related to that business and a deduction has been allowed in respect of expenditure on scientific research under Section 35, the actual cost of the asset to the assessee should be taken to be the original cost to the assessee minus the amount of any deduction under Section 35 of the Act, originally allowed.
- (b) Assets acquired by way of gift or inheritance  
In cases where the depreciable asset is acquired by the assessee by way of gift or inheritance, the actual cost of the asset to the assessee shall be the actual cost to the previous owner, as reduced by –
  - (a) the amount of the depreciation actually allowed to the donor or predecessor in respect of any previous year relevant to the

assessment year commencing before the 1st day of April, 1988,  
and

- (b) the amount of depreciation that would have been allowable to the assessee for any assessment year commencing on or after the 1st day of April, 1988, as if the asset was the only asset in the relevant block of assets. In case where a portion of the cost of an asset is acquired by the assessee has been met directly or indirectly by the Central Government or State Government or any authority established under any law, or by any other person, in the form of subsidy or grant or reimbursement, then in case where the subsidy is directly relatable to the asset such subsidy shall not be included in the actual cost of the asset. In case where such subsidy or grant or reimbursement is of such a nature that it cannot be directly relatable to any particular asset, the amount so received shall be apportioned in a manner that such asset bears to all assets in respect of or with reference to which the subsidy or grant or reimbursement is so received and such subsidy shall not be included in the actual cost of the asset.
- (c) Assets transferred to reduce tax liability In cases where prior to the date of acquisition by the assessee the depreciable asset was at any time used by any other person for the purpose of his business or profession and the Assessing Officer is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was to secure a reduction of liability to income- tax by claiming depreciation with reference to the enhanced cost, the actual cost of the asset to the assessee should be taken at such amount as the Assessing Officer may, with the prior approval. of the Deputy Commissioner, determine having due regard to all the circumstances of the case. For instance, if 'X' transfers his machinery on 1.1.1990 to 'Y' for a sum of 6.00 lakhs while the actual cost of the asset

and the written down value thereof on that day to 'X' are ` 3.00 lakhs and ` 1.00 lakh respectively, it may be inferred that the transfer by 'X' to 'Y' is made with idea to enable 'Y' to claim depreciation on ` 6.00 Lakhs while the market value of the asset on the date of sale by 'X' to 'Y' may be ` 4.00 lakhs only. In such a case, the Assessing Officer would be entitled to allow depreciation to 'Y' on the basis of the cost which may be determined by him to be ` 4.00 lakhs instead of ` 6.00 lakhs as claimed by 'Y'.

- (d) Assets earlier transferred re-acquired by the Assessee : There may be cases where depreciable asset would have once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter it might have ceased to be his property by reason of its transfer or otherwise. If such a depreciable asset is re-acquired by the assessee himself, the actual cost of the asset should be taken to be the least of either
- (a) actual cost of the asset to the assessee when it was first acquired by him minus (i) the depreciation actually allowed to him in respect of any previous year relevant to the assessment year commencing before the 1st day of April, 1988, and (ii) the amount of depreciation that would have been allowable to the assessee for any assessment year commencing on or after the 1st day of April, 1988, as if the asset was the only asset in the relevant block of assets or.
  - (b) the actual price for which the asset is re-acquired by him.
- (e) Building brought into use for business purpose subsequent to its acquisition: In cases where a building which was previously the property of the assessee is brought into use for the purpose of his business or profession after 28-2-1946, the actual cost of the building to the assessee

should be taken to be the original cost of the building minus the amount equal to the depreciation calculated at the rate in force at that date which would have been allowable had the building been used for purposes of the business or profession ever since the date of its acquisition by the assessee.

- (f) Asset transferred by holding company to 100% subsidiary company or vice-versa: In cases where any depreciable asset is transferred by an Indian holding company to its wholly owned subsidiary or vice versa, then the actual cost of the transferred asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the transferred capital asset for the purposes of its own business.
- (g) Asset transferred under a Scheme of Amalgamation: In the case of an amalgamation as defined in Section 2(1B) of the Act, if any depreciable asset is transferred by the amalgamating company to the amalgamated company, which is an Indian company as defined in Section 2(26) of the Act, the actual cost of the transferred capital asset to the amalgamated company must be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business.
- (h) Asset transferred to the resulting company in case of demerger: In case of demerger, any capital asset is transferred by the demerged company to the resulting company and the resulting company is an Indian company, the actual cost of the transferred capital asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business. Provided that such actual cost shall not exceed the written down value of such capital asset in the hands of the demerged company.

- (i) Interest Pertaining to Post Acquisition Period: Where any amount is paid or is payable as interest in connection with the acquisition of an asset, so much of such amount as is relatable to any period after such asset is first put to use shall not be included, and shall be deemed never to have been included, in the actual cost of such asset.
- (j) Actual Cost of Cenvetable Asset: Where an asset is or has been acquired on or after the 1st day of March, 1994 by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 (51 of 1975) in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944.
- (k) Asset acquired where portion of cost met by some other person: Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee :

Provided that where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the (l) Asset acquired by non-resident outside India but for business or profession in India

Where an asset which was acquired outside India by an assessee, being a non-resident, is brought by him to India and used for the purposes of his

business or profession, the actual cost of the asset to the assessee shall be the actual cost to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee.

- (m) Asset acquired under scheme of corporatisation of Recognised Stock Exchange: Where any capital asset is acquired by the assessee under a scheme for corporatisation of a recognised stock exchange in India, approved by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the actual cost of the asset shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatization.
- (n) Capital Asset on which deduction has been allowed or allowable u/s 35AD: The actual cost of any capital asset on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be treated as nil:
  - (a) in the case of such assessee; and
  - (b) in any other case if the capital asset is acquired or received:
    - (i) by way of gift or will or an irrevocable trust;
    - (ii) on any distribution on liquidation of the company; and
    - (iii) by such mode of transfer as is referred to in clauses (i), (iv), (v), (vi), (vib), (xiii) and(xiv) of section 47. Depreciation is not allowed in case of a foreign car acquired by the assessee after 28th day of February, 1975 and used otherwise than in a business of running it on hire for tourists or is not used outside India in business or profession carried on by the assessee in another country.

In cases where the assessee acquires the business of another, the original cost of the depreciable asset to the assessee would be the value at which assets are taken over by him and not the original cost of those assets to the previous owner of the business. However, in case of succession by inheritance or gift where the actual cost to the assessee is taken to be the actual cost to the previous owner as reduced by the amount of depreciation actually allowed under the Act. In cases of partition of a HUF, if depreciable assets are divided amongst the members thereof at a genuine valuation, the cost of the asset to the member who, after the partition, uses the asset for the purposes of his business should be taken to be the value at which he takes over the asset.

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

The written down means: In the case of assets acquired in the previous year, the actual cost of the assets to the assessee. In the case of assets acquired before the previous year the actual cost of the assets to the assessee less all depreciation actually allowed to him in that Previous Year. In the case of any block of assets the written down value will be determined as under:

Total of written down value of all the assets falling within a block at the beginning of the previous year relevant to the assessment year	.....
Add: The actual cost of, any new assets falling in the block, acquired during the previous year	.....
Less: Moneys payable in respect of any asset, falling within that block which is sold, discarded, demolished or destroyed during the previous year together with the amount of scrap value in respect of any asset. The amount of deduction cannot exceed the written down value as so increased	-----
Written down value for the assessment year	.....
Less: Depreciation during the previous year relevant to the assessment year	.....
Written down value at the beginning of the previous year relevant to the next assessment year	.....

The addition/deduction as aforesaid may be made for calculating written down value for the concerned previous year.

The written down value of any block of assets may be reduced to nil in the following cases:

- (i) Where money receivable in respect of assets sold or otherwise transferred during the previous year plus the amount of scrap value is more than the written down value at the beginning of the previous year as increased by the actual cost of any new asset acquired.
- (ii) Where all the assets in the relevant block are transferred during the year.

### **Classification of depreciation**

- (a) Normal Depreciation [Section 32(1) Rule 5]

Normal depreciation is calculated at the specified percentage on the written-down value of block of assets (including ocean going ships). Further, where any new machinery or plant is installed during the previous year for the purposes of manufacture or production of any article or thing, and such article or thing (a) is manufactured or produced by using any technology or know-how developed in, or (b) is invented in, a laboratory owned or financed by the Government or owned by a public sector company or university or a duly recognised institution, then such plant or machinery shall be treated as part of block of assets qualifying for depreciation @ 50% of written down value subject to the fulfillment of the following conditions:

- (i) the right to use such technology or know-how or to manufacture such article or thing has been acquired from the owner of the laboratory or from any person who has derived the right from such owner;

- (ii) the return furnished by the assessee for his income or the income of any other person for which he is assessable for any previous year in which the said machinery or plant is acquired is accompanied by a certificate from the prescribed authority (Secretary, Department of Scientific and Industrial Research, Government of India) to the effect that such technology or know-how is developed in, or the article or thing is invented in such laboratory; and the machinery or plant is not used for the purposes of business of manufacture or production of any article listed in the Eleventh Schedule (i.e. low priority articles).

**(b) Depreciation on Straight line basis**

In the case of Power Units [Section 2(1)(i)] (optional to power generating units) From the assessment year 1998-99, an undertaking engaged in generation or generation and distribution of power can claim depreciation on straight line basis on the actual cost of individual asset. But the aggregate depreciation can not exceed the actual cost. Alternatively, such undertaking can claim depreciation, at its option, according to written down value method like any other assessee. The option for this purpose shall be exercised before the due date of furnishing return of income. Once this option is exercised, it shall be final and shall apply to all the subsequent years.

**Terminal depreciation**

If any asset, on which depreciation is claimed on basis of SLM, is sold and the amount by which money payable together with scrap value, fall short of WDV of such asset, depreciation shall be allowed equal to such deficiency in the year of sale.

### **Balancing Charge Section 41(2)**

If any asset, on which depreciation is claimed on basis of SLM, asset is sold and the amount by which moneys payable together with scrap value, exceeds WDV of such asset, then the least of the following shall be taxable under the head PGBP.

- (i) difference between the actual cost and WDV
- (ii) difference between aggregate of moneys payable and WDV
- (c) Additional Depreciation [Section 32(1)(ia)]: With effect from Assessment year 2006-07 existing clause (ia) has been substituted by new Clause (ia) to provide additional depreciation in certain circumstances. The additional depreciation shall be allowed @20% of the actual cost.
- (iv) Calculation of Written Down Value of a block of asset [Section 43(6)]**
  - (a) Find out the written down value on the first day of the previous year (WDV) relevant to the assessment year, of all those depreciable assets on which the depreciation is allowed at the same rate. All such assets are known as “block assets”
  - (b) The increase in the WDV by the actual cost of any asset falling within that block, acquired during the previous year;
  - (c) Reduce from the above, the moneys payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, so that the amount of such reduction does not exceed the written down value as so increased; and
  - (d) In the case of a slump sale, decrease by the actual cost of the asset falling within the block as reduced by the amount of depreciation

that would have been allowable to the assessee for any assessment year, so that the amount of such decrease does not exceed the written down value. It means if the net consideration of an asset out of the block is less than the balance under (ii), there would be no capital gain. If the net consideration of an asset is more than the balance under (ii) (the value of all assets in the block) the excess shall be deemed to be short term capital gain. If all the assets of the block are sold in the previous year and the net consideration is less than the balance under (ii), the loss shall be deemed to be short term capital loss. Where any capital asset is acquired by the assessee under a scheme for corporatisation of a recognised stock exchange in India, approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India, 1992 (15 of 1992), the actual cost of the asset shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatisation.

### **Treatment of Depreciation in the case of Succession, Amalgamation & Demerger**

The fifth proviso to Section 32(1) provides that in cases of succession in business or profession, in the case of amalgamation of companies or in the case of demerger of companies depreciation of plant and machinery, buildings and furniture in any previous year shall not exceed the depreciation calculated at the prescribed rate as if the succession, amalgamation or demerger had not taken place. It also seeks to allow the deduction to the predecessor and the successor or the amalgamating company and the amalgamated company or the demerged company and the resulting company in the same proportion as the number of days for which they used the asset in the business or profession. Section 38(2)

provides that where any building, machinery, plant or furniture is not exclusively used for the purposes of the business or profession, the deduction under Sections 30(a) & (c), 31(i) & (ii) and 32(1)(ii) shall be restricted to a fair proportionate part thereof as may be determined by the Assessing Officer.

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#### **4.5 COMPUTATION OF INCOME FROM BUSINESS OR PROFESSION**

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##### **a. Computation of business profits**

For computation of business profits, the profit & loss account serves as the basis. The profit & loss account shows certain expenses and losses which are either fully or partly disallowed under the provisions of Income tax Act. On the credited side there are certain incomes which are either tax free or are not taxable under this head. The following table can help to compute the business income of an assessee:

	Balance as per P& L a/c	Profit (+) Loss (-)	
<b>1</b>	<b>Add expenses claimed but not allowed under the act</b>		
i	All provisions and reserves (bad debts/dep/income tax etc.) except creation of reserves by financial corp. u/s 36	xx	
ii	All taxes (income tax, wealth tax, advance income tax etc. except sales tax, excise duty and local taxes of premises used for business)	xx	
iii	Rent paid to self	xx	
iv	All capital expenses except on scientific research	xx	
V	All capital losses	xx	
Vi	All charities and donations	xx	
vii	All expenses related to other heads of income (house property etc.)	xx	
viii	Cultivation expenses	xx	
ix	Any interest on capital unless the amount is borrowed	xx	
x	All personal expenses	xx	

xi	Any depreciation if wrongly debited	XX	
xii	Gifts and presents	XX	
xiii	Any type of fine or penalty	XX	
xiv	Any payment to a partner (by way of salary, interest, commission etc. under prescribed limits)	XX	
xv	Any salary or interest payable out-side India unless tax is deducted at source or is paid according to the law	XX	
xvi	Past year losses	XX	
xvii	Any other expenses which is not incurred according to the provisions of law	XX	
xviii	Salary paid to self or any other family member	XX	
xix	Personal life insurance premium	XX	
xx	Amount invested in NSC, NSS, PPF etc	XX	
xxi	Rent for residential portion	XX	
xxii	Speculation loss	XX	
xxiii	Bad debt still recoverable	XX	
xxiv	Legal expenses on criminal case, acquiring of assets, curing title of asset	XX	
xxv	Loss by theft from residence	XX	
xxvi	Expenses on illegal business	XX	
xxvii	Employers contribution to unrecognised PF	XX	
xxviii	Difference in trial balance	XX	
xxix	Difference due to under crediting of stock	XX	
xxx	Cost of patent rights	XX	
xxxi	Cost of technical know how	XX	
xxxii	Preliminary expenses	XX	
xxxiii	Total (after adjustment if there is loss balance)		<b>A</b>
<b>B</b>	<b>Deduct from total A any expenditure which is allowable under the act , but has not been debited to P&amp;L a/c</b>		
i	Actual bad debts	XX	
ii	Depreciation	XX	
iii	Any other expenditure incurred according to the provision of law	XX	
iv	Difference due to under debiting of stock	XX	(xxx)
v	Balance		<b>B</b>

<b>C Deduct out of the amount balance B any income which is either exempt or not taxable under this head</b>			
a)	Incomes exempted from tax	XX	
i	Post office saving bank interest	XX	
ii	Agriculture receipt	XX	
iii	Gifts from relatives	XX	
iv	Income tax refund	XX	
v	Bad debts recovered	XX	
vi	Life insurance maturity amount	XX	
vii	Any capital receipt	XX	
viii	With drawl from PPF	XX	
b)	Income taxable under other heads	XX	
i	Part time salary	XX	
ii	Interest on securities	XX	
iii	Rent from house property let	XX	
iv	Capital gain	XX	
v	Dividend, bank, interest, winnings from lotteries, race course	XX	
			(xxx)
	Taxable profit from business		xxx
	Add income from other business legal or illegal		xx
	income taxable under the head profit and gains from business		xxxx

**b. Computation of professional income**

Professionals do not prepare profit and loss account but they prepare income and expenditure account from the receipts and payment account. To compute the professional income it is easier to take professional receipts of the previous year and deduct out of these the professional expenses incurred during the year.

**1) In case of doctor or medical practitioner**

	<b>Professional receipts</b>		
I	Consultation fees	XX	
li	Operation fees	XX	
lii	Visiting fees	XX	
Iv	Sale of medicines	XX	
V	Gifts from patients	XX	
Vi	Value of any perquisites	XX	
vii	Examiner's fees	XX	
viii	Nursing home receipts	XX	
Ix	Any other professional receipts	XX	
	Total receipts		xxx
Less:	Professional expenses		
X	Dispensary expenses like rent, water etc, salary to staff, telephone expenses etc	xx	
Xi	Cost of medicines	xx	
	a) If accounts are maintained on cash basis: cost of actual medicines purchased during previous year b) If accounts are maintained on mercantile basis: op stock+ new purchases-closing stock		
xii	Depreciation on surgical equipment and x ray, machines etc	xx	
xiii	Cost of books for professional purposes	xx	
xiv	Motor car expenses: dep. relating to professional work	xx	
Xv	Expenditure incurred to increase professional knowledge	xx	
xvi	Nursing home expenses	xx	
xvii	Any other expenditure incurred during the year	xx	-(xxx)
xviii	<b>Professional income</b>		xxx

**1) In case of chartered accountant**

	<b>Professional Receipts</b>		
I	Audit fees	XX	
li	Income from accountancy work	XX	
lii	Institute fees	XX	
Iv	Examiner's fees	XX	
V	Gifts from clients	XX	
Vi	Consultancy services	XX	
vii	Any other receipt	XX	
	Total receipts		xxx
Less	Professional expenditure		
I	Office expenses	XX	
li	Institute expenses	XX	
lii	Cost of books	XX	
Iv	Motor car expenses	XX	
V	Membership fees	XX	
Vi	Depreciation on office equipments etc.	XX	
vii	Any other expenditure to increase professional knowledge	XX	
viii	Stipend to trainees	XX	
Ix	subscriptions	XX	
X	Dep. on office furniture	XX	
	Total expenses		(xxx)
	Professional income		xxx

**3. In case of a lawyer or an advocate**

	<b>Professional receipts</b>		
I	Practising fees	XX	
li	Legal fees	XX	
lii	Special commission	XX	
Iv	Presents from clients	XX	
V	Examiner's fees	XX	
Vi	any other receipts	XX	
	Total professional receipt		xxx
<b>Less</b>	<b>Professional expenses</b>		
I	Office expenses	XX	
li	salary of staff	XX	

ii	salary of staff	XX	
iii	Cost of books	XX	
iv	Depreciation of office equipments	XX	
v	Expenditure incurred to increase professional knowledge	XX	
vi	subscription	XX	
vii	Purchase of stamp paper and court fee	XX	
viii	Travelling expenses	XX	
	Total professional expenses		(xxx)
	Professional gain		xxx

### ILLUSTRATION

From the following Profit and Loss Account of a Merchant for the year ending 31st March, 2020. Compute his income from business and his total income for assessment year 2020-21:

#### Profit and Loss Account

Particulars	Rs	particulars	Rs
To Trade expenses	700	By Gross Profit	35200
To Salary	2,500	By Dividend From A Cooperative Society	3000
To Rent, Rates and Taxes	2,400	By Income From A Property	850
To Income-tax	1,400	By Interest From Govt. Securities (Gross)	2,000
To Discount and allowance	300		
To Household expenses	2,000		
To Life Insurance Premium	1,000		
To Interest on Capital	500		
To Interest on loan	700		
To Advertisement	800		
To Postage and Telegram	50		
To Audit Fee	200		
To Provision for gratuity	4,000		
To Fire Insurance Premium	730		
To Provision for bad debts	2,000		
To Provision for Income-tax	1,800		
To Depreciation	4,000		
To Net Profit	15,970		
	41050		41050

**Solution:****Computation of Total Income for the Assessment Year 2020-21**

	Rs	Rs
Income from house property:		
– Income from property	850	
Less: 30% under Section 24	(255)	
Income from house property		595
Income under the head Business or Profession		
Net Profit	15,970	
Add: Inadmissible items:		
– Income tax	1,400	
– Household Expenses	2,000	
– Life Insurance Premium	1,000	
– Interest on Capital	500	
– Provision for gratuity	4,000	
– Provision for bad debts	2,000	
– Provision for Income-tax	1,800	
Less: Income to be shown separately:		
– Dividends from a cooperative society	3,000	
– Income from property	850	
– Interest from Government Securities	2,000	
Taxable Profits from Business		22,820
Income from other sources:		
Dividends from cooperative society	3,000	
Interest from Government Securities	2,000	
Income from other sources		5,000
<b>Gross Total Income:</b>		<b>28,415</b>

**Notes:**

1. Provision for gratuity is not admissible. However, payment of actual gratuity is allowed.
2. It is assumed that income from property is by way of rent received and as per the provision of Section 24 of the Act, thirty percent thereof has been deducted as repair allowance.

## ILLUSTRATION

Following particulars are supplied by a textile unit situated in Mumbai for the assessment year 2020-21:

Block of Assets	WDV as on 1.4.2018	Additions	Sale	Rate of Dep.
1	2	3	4	5
Factory building	20,50,000	8,00,000 (completed on 15.1.2019)	—	10%
Residential buildings	50,00,000	5,00,000 (completed on 31.7.2018)	—	5%
Plant and Machinery	90,00,000	3,00,000 (on 5.10.2018)	11,00,000	15%
Furniture and fittings	10,30,000	1,00,000 (on 10.10.2018)	3,50,000	10%
You are required to calculate the amount of allowable depreciation under the Income-tax Act, 1961				
Solution:				
Computation of Depreciation				
Factory Building	Rs	@	Amount (Rs)	
WDV as on 01.04.2018	20,50,000	10%	2,05,000	
Addition on 15.01.2019	8,00,000	50% of 10%	40,000	
			2,45,000	
Residential Building				
WDV as on 1.4.2018	50,00,000	5%	2,50,000	
Addition as on 31.7.2019	5,00,000	5%	25,000	
			2,75,000	
Plant and Machinery				
WDV as on 1.4.2018	90,00,000			
Less: Sale	(11,00,000)			
	79,00,000	15%	11,85,000	
Addition as on 5.10.2018	3,00,000	50% of 15%	22,500	
Additional depreciation on new		20% of 3,00,000	60,000	

investment			12,67,500
Furniture			
WDV as on 1.4.2018	10,30,000		
Less: Sale	(3,50,000)		
	6,80,000	10%	68,000
Addition as on 10.10.2018	1,00,000	50% of 10%	5,000
			73,000

Note: In the case of assets which are put to use in the business for a period of less than 180 days, the depreciation permissible is @ 50% of the normal rate

### Illustration

#### Profit and loss account of M/s Raj & Company

General expenses	107,000	Gross profit	540,000
Fire insurance premium	2,000	Bad debts, recovered but disallowed earlier	4,000
Bad debts	1,000	Interest from govt. securities	4,000
Salaries	165,000	Rent received from employees	12,000
Advertisement in cash	22,250	Interest from debtors for delayed payment	6,000
Proprietor's salary	112,500		
Interest on capital	2,000		
Income tax	1,000		
Depreciation	2,000		
GST 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	139,000		
	566,000		566,000

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 to Rs 2,900. GST was paid on 1-5-2020. Date of filing of return is 31-7-20120. 50 % of motor car expenses are for proprietor's personal use. Compute business income.

### Solution. Computation of business income

Net profits as per P/L a/c		139,000
<b>Add: Inadmissible expenses</b>		
Advertisement in cash	22,250	
Proprietor's salary	112,500	
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>143,825</u>
		<u>282,825</u>
<b>Less: expenses allowed but not debited</b>		
Depreciation		<u>2,900</u>
		<u>279,925</u>
<b>Less: incomes not taxable under this head</b>		
Bad debt recovered disallowed earlier	4,000	
Interest on govt. securities	<u>4,000</u>	<u>8,000</u>
<b>Taxable business income</b>		<u>271,925</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 31<sup>st</sup> march, 2020.

Salaries to employees	195,000	Gross profit	580,000
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		
GST due and paid on 1-7-2018	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 profits	<u>190,000</u>	
	<u>631,000</u>	<u>631,000</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 30-06-2020 and date of filing of return is 31-07-2020

Solution: computation of business income of a cycle manufacturer

Profit as given in the profit and loss a/c		190,000
Add: Inadmissible expenses		
Drawings	24,000	
Interest on proprietor's capital	7,000	
Return to proprietor	4,000	
Car purchased	72,000	
Donations	2,000	
Provisions for bad debts	6,000	
Legal charges ( Being capital expenses)	3,000	
Repairs on let out building	1,250	
Depreciation	15,000	
Advertisement expenses paid in cash	<u>24,000</u>	<u>158,250</u>
		<u>348,250</u>
Less: Income to be treated under separate heads:		
Income from interest on securities	14,000	
Income from house property	<u>25,000</u>	39,000
Less: Allowable depreciation		<u>14,400</u>
Income from business		<u>294,850</u>

**Illustration :**

From the following statement, compute the income from profession of Dr. S.K.Kapoor if accounts are maintained on cash and receipt system:

To dispensary rent	36,000	By visiting fees	45,000
To electricity and water charges	6,000	By consultation fees	125,000
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 of 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>247,000</u>		<u>247,000</u>

Notes;

1. electricity and water charges include domestic bills 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 Rs 4,000

Solution:

Computation of professional income of Dr. S.K Kapoor

<b>Professional receipts:</b>		
Visiting fees	45,000	
Consultation fees	125,000	
Sale of medicines	<u>72,000</u>	242,000
<b>Less: Professional expenses</b>		
Dispensary rent	36,000	
Electricity and water charges ( 6,000- 2,500)	3,500	
Telephone expenses ( 6,000 x 60 %)	3,600	
Salary to staff	36,000	
Depreciation on surgical equipment	6,000	
Cost of medicines [ 6,000 + 36,000 -4,000]	38,000	
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>	
Professional gains		<u>107,700</u>

Illustration : The following is the profit and loss of a merchant for the year ending 31-3-2020

Profit and loss account

To office salary	206,500	By gross profit	436,750
To bad debts written off	1,700	By commission	1,250
To provision for bad debts	3,000	By discounts	500
To advertisement	53,800	By sundry receipts	200
To fire insurance premium (H.P)	550	By rent of building	3,600
To general expenses	52,750	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>122,500</u>		
	<u>445,300</u>		<u>445,300</u>

Compute the taxable profits from business . The amount of depreciation is Rs 1,000. Interest on bank loan was paid on 1-8-2019 . Due date of filing of return is 31-3-2020.

Solution:

Computation of business profits

Net profits as per P/L a/c		122,500
Add: Expenses not allowed		
Provision for bad debts	3,000	
Fire insurance premium	550	
Depreciation	1,200	
Interest on capital	2,000	
Interest on bank loan paid on 1-8-2019	<u>1,300</u>	<u>8,050</u>
		<u>130,550</u>
Less: allowable depreciation		<u>1,000</u>
		<u>129,550</u>
Less: Incomes chargeable to tax under other heads		
Rent of building	3,600	
Profit on sale of investments	<u>3,000</u>	<u>6,600</u>
Business income		<u>122,950</u>

### Illustration

Mr. D.D Dewan and company are chartered accountants in Delhi. They have submitted the following income and expenditure account for the year. Compute the income from profession.

<b>Expenses</b>		<b>Incomes</b>	
To drawings	48,000	By audit fees	224,000
To office rent	42,000	By financial consultancy service	98,000
To telephone installation charges under OYT 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 to staff	66,000	By accountancy works	24,000
To charaties	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>133,300</u>		
	<u>356,000</u>		<u>356,000</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 and Co

<b>Professional receipts</b>		
Audit fees	224,000	
Financial consultancy works	98,000	
Accountancy works	<u>24,000</u>	
		346,000
<b>Less: Professional expenses</b>		
Office rent	42,000	
Telephone installation charges	15,000	
Electricity bill	4,200	
Salary to 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	3,500	
Professional gain		<u>161,100</u>
		<u>184,900</u>

## Unsolved problems

Problem 1 :Following is the profit and loss account of Bappi Lehri for the previous year 2019 -20

To salaries	25,650	By gross profit	80,000
To rent	1,000	By bank interest	450
To commission on sales	100	By bad debts recovered last year	2,000
To income tax	2,600	allowed	
To entertainment expenses	600	By rent from house property	4,800
To commission paid to collect interest on securities	25	By interest on commercial securities	2,000
To embezzlement by cashier	1,000		
To municipal tax of H.P	600		
To bad debts ( Allowed)	450		
To repairs to house	1,625		
To office expenses	9,180		
To depreciation	5,000		
To LIC premium	1,320		
To net profit	<u>40,100</u>		
	<u>89,250</u>		<u>89,250</u>

Problem 2: The following is the P/L a/c of Chetan on the basis of which compute his gross total income for the assessment year 2020-21:

To salaries and wages	12,000	By gross profit	48,200
To rent rates and taxes	3,200	By rent from house property	6,000
To trade expenses	1,450	By dividend from an Indian co.	2,400
To advertisements	950		
To household expenses	3,500		
To discount and rebate	1,250		
To postage and stationery	275		
To fire insurance premium ( let out house property)	300		
To reserve for bad debts	1,000		
To LIC premium	1,000		
To donation to an approved school	1,000		
To income tax	3,300		
To repairs ( House property)	500		
To audit fees	300		
To loss of stock in trade	1,000		
To depreciation	1,000		
To interest on capital	200		
To net profit	<u>24,375</u>		
	<u>56,600</u>		<u>56,600</u>

#### 4.7 SUMMARY

- Sections 28 to 44D contain the provisions for computation of Income from Business and Profession.
- Section 28 defines the scope of income which can be taxed under this head.
- Sections 29 to 44D specify the method of computation of income under the business or profession.
- Expenses/allowances expressly allowed by the Act are listed under sections 29 to 37, whereas sections 40, 40A and 43B enumerate those expenses which are expressly disallowed while computing taxable income under this head.
- Section 44AA provides for maintenance of accounts by the assessee carrying on business or profession.
- Mandatory tax audit of accounts of the persons carrying on business or profession is prescribed in section 44AB.
- Computation of profit from business and profession on presumptive basis are covered under sections 44AD and 44AD.
- Section 44B laid down special provisions for computing profits and gains of shipping business in case of non-residents.
- Section 44D prescribed for special provisions for computing income by way of royalties etc, in case of foreign companies.

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#### 4.8 GLOSSARY

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**Plant :** The term 'plant' for the purpose of allowance of depreciation has been defined in Section 43(3) to include ships, vehicles, books, scientific apparatus and surgical equipments used for the purposes of the business or profession.

**Block of Assets:** The depreciation is provided in respect of “Block of assets”. As per Section 2(11) Block of assets means “a group of assets falling within a class of assets, being tangible assets such as buildings, machinery, plant or furniture and intangible assets, being know-how, patents, copyrights, trademarks, licences, Franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed”.

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#### **4.9 SELF ASSESSMENT QUESTIONS**

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**1. What are the provisions for the treatment of depreciation u/s 32 ?**

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**2. What are the expenses expressly disallowed under the computation of income from business or profession?**

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**1. Give a brief account of the deductions allowed u/s 30-40A of Income tax Act?**

**2. From the following Statement compute the income profession of Dr. S. K. Kapoor if accounts are maintained on mercantile system:**

particulars	Rs	particulars	Rs
To dispensary rent	30000	By visiting fees	35000
To electricity and water charges	3000	By consultation fees	115000
To telephone expenses	6000	By sale of medicines	72000
To salary to nurses and compounder	35000	By dividends	5000
To depreciation on surgical equipments	2000		
To purchase of medicines	36000		
To depreciation on X-ray machine	4000		
To income tax	3500		
To donation to Rama Krishna Mission	4000		
To motor car expenses	7600		
To depreciation on car	2800		
To net income	93100		
	227000		227000

- electricity and water charges includes domestic bill of Rs 2500
- Half of motor car expenses are for professional use.
- Telephone expenses include 40% for personal use
- Opening stock of medicines was Rs 6000 and closing stock was Rs 4000

Problem 3 :Following is the profit and loss account of Bappi Lehri for the previous year 2019 -20.

To salaries	25,650	By gross profit	80,000
To rent	1,000	By bank interest	450
To commission on sales	100	By bad debts recovered last year allowed	2,000
To income tax	2,600	By rent from house property	4,800
To entertainment expenses	600	By interest on commercial securities	2,000
To commission paid to collect interest on securities	25		
To embezzlement by cashier	1,000		
To municipal tax of H.P	600		
To bad debts ( Allowed)	450		
To repairs to house	1,625		
To office expenses	9,180		
To depreciation	5,000		
To LIC premium	1,320		
To net profit	<u>40,100</u>		
	89,250		<u>89,250</u>

Problem 4: The following is the P/L a/c of Chetan on the basis of which compute his gross total income for the assessment year 2020-21:

To salaries and wages	12,000	By gross profit	48,200
To rent rates and taxes	3,200	By rent from house property	6,000
To trade expenses	1,450	By dividend from an Indian co.	2,400
To advertisements	950		
To household expenses	3,500		
To discount and rebate	1,250		
To postage and stationery	275		
To fire insurance premium ( let out house property)	300		
To reserve for bad debts	1,000		
To LIC premium	1,000		
To donation to an approved school	1,000		
To income tax	3,300		
To repairs ( House property)	500		
To audit fees	300		
To loss of stock in trade	1,000		
To depreciation	1,000		
To interest on capital	200		
To net profit	<u>24,375</u>		
	<u>56,600</u>		<u>56,600</u>

#### 4.10 SUGGESTED READINGS

1. **Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.**
2. **Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.**
3. **Study Material, Executive Programme, Tax Laws And Practice Module I, Paper 4: The Institute Of Company Secretaries Of India, New Delhi, [www.icsi.com](http://www.icsi.com).**
4. **V.P. Gaur, D. B. Narang, Puja Ghai and Rajeev Puri: Income Tax Law and Practice: Kalyani Publishers, New Delhi.**