

UNIVERSITY OF JAMMU
B.COM. FOURTH SEMESTER
INCOME TAX LAW AND PRACTICE - II

Course No. BCG-402

Max Marks = 100

Internal assessment = 20

External exam. = 80

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

UNIT I: CAPITAL GAINS

Meaning of capital assets; Short term and long term capital gain and loss, computation of capital gain, indexing of cost of acquisition and improvement.

Deductions u/s 54, 54B, 54D, 54EC, 54ED, 54F

Income from Other Sources: Computation of general income u/s 56(1) and specific income u/s 56(2), and grossing up of income falling under other sources, Interest on securities, types of securities.

UNIT II:

Set off and carry forward of losses, aggregation of income, deductions from gross total income for individuals, HUF's and Firms

UNIT III: Assessment of individuals and H.U.F including computation of tax liability.

UNIT IV: Assessment of firms and association of persons. including computation of tax liability

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

- Create deep understanding of all concepts specified in the syllabus.

- Enable the students in computing income and tax liability of various assesses as specified above.

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. Singhania & Kapil Singhania- 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 – II

Max Marks: -80

Time allowed: 3hrs

Section- A (Marks 20)

(5 Marks x 4)

Attempt all questions. Each question carries five marks.

1. Discuss the concept of book profit with suitable example.
2. Write a short note on set off and carry forward of losses.
3. Calculate tax payable in case of individual for the assessment year..... with suitable example.
4. Discuss long term capital gain & short term capital gain.

Section- B (Marks 60)

(15 Marks x 4)

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

UNIT-I

1. Mr. X purchased a house in 1976 for Rs. 1,00,000. He incurred the following expenses for the improvement of the house.

Renovation of the house for Rs. 25,000 and addition of 2 rooms after one year for Rs. 50,000. The F.M.V. of the house on 1-4-81 was Rs. 110,000. He sold the house in May 2012 for Rs. 14,00,000.

He purchased another house property within 2 months for Rs. 3,00,000 and invested in capital gains account scheme Rs. 50,000. Calculate taxable capital gain for the previous year_____. Cost inflation index for 1981-82 was 100 and for 1912-13 is 852.

OR

Following are the particulars for the year _____. Compute income under the head other sources.

| | Rs. |
|---|--------|
| (i) Card games loss | 12,000 |
| (ii) From the activity of owning and Maintaining horses for race purpose | |
| (a) Loss at Bombay | 40,000 |
| (b) Profit at Banglore | 20,000 |
| (iii) Dividend (gross) | 6,000 |
| (iv) Betting in horse races | 400 |

UNIT-II

2. Mr. X earned gross total income of Rs. 5,00,000. In the previous year _____ and made the following donation during the year.

- (i) Rs. 10,000 to chief Minister's earthquake relief fund.
- (ii) Rs. 15,000 to National foundation for communal harmony.
- (iii) Rs. 20,000 for municipal corporation approved for promotion of family planning.
- (iv) Rs. 45,000 to approved institutions.

Calculate the amount of deduction admissible to him u/s 80G.

OR

Discuss with suitable example rules regarding set off and carry forward of losses.

UNIT-III

3. Mr. K.L.Seth a resident of Delhi [population above 25 lakhs] submits the following details of his income for the financial year.....

| | |
|--------------------------------|----------|
| Salary | 7000 p.m |
| DA | 6000 p.m |
| Entertainment allowance | 350 p.m |
| City compensatory allowance | 250 p.m |
| Bonus | 7000 |
| Employer's contribution to RPF | 12000 |
| His own contribution to RPF | 12000 |
| Interest on RPF balance @ 13% | 7800 |

He is provided with an unfurnished accommodation for which employer charges Rs. 200 p.m. The municipal value of the house owned by employer is Rs. 22050 p.a. He is also provided by employer with chauffeur driven car of 1.8 lt. capacity. The car is used for official purposes only and the entire expenses of its running and maintenance are met by the employer.

During the year Mr. K.L Seth has received dividends from co-op, society amounting to Rs. 14000. He paid insurance premium of Rs. 3000 on a policy taken on his the life of his father who is not dependent on him. During the year he had following income also.

- (a) Winnings from lottery Rs. 50000 out of which tax @30% has been deducted atsource.
- (b) He went to Nepal and won Rs. 35000 from gambling in a casino.
- (c) He lost Rs. 20000 in card games during Diwali season.
- (d) He earned Rs. 14910 from his term deposits with a bank.

Computes his total income and tax liability for the assessment year.....

OR

HUF with more than one co-parcener entitled to claim partition, owns a property which is let out at Rs. 600 p.m per unit. The property consists of 10 identical residential units. The municipal rental value of the property is Rs. 60,000p.a.

| Following deductions are claimed as expenses: | Rs. |
|---|-------|
| Municipal taxes | 4200 |
| Lift maintenance | 2000 |
| Water pump expenses | 800 |
| Actual expenses on repairs | 8000 |
| Cost of renovation of the property | 50000 |
| Education cess levied by the state govt. | 2000 |
| Rent collector monthly salary | 200 |
| Interest on loan taken by mortgaging the property and loan was used for the family business | 5000 |

Income from the family business for the assessment year..... was Rs. 160000 after charging interest on loan. A lottery ticket worth Rs. 100 was purchased out of family funds on the name HUF. It won a prize of rs. 100000. The Karta had acquired a shop out of his own savings which he wife. Shop has an annual income (computed under the headhouse property) of Rs. 24000.

Compute total income of HUF and tax payable for the assessment year

UNIT-IV

4. From the information given below find out the amount of remuneration which can be debited to P & LA/c of the firm and how much income of partners shall be chargeable to tax under the head profits and gains. Salary and interest to partners has been paid as per deed.

CAPITAL GAINS

STRUCTURE:

1.1 Introduction

1.2 Objective

1.3 Concept of Capital Gain

1.4 Meaning of Capital Asset

1.4.1 Kinds of capital assets

- Short-Term Capital Asset
- Long-Term Capital Asset

1.4.2 Transfer of capital asset

1.4.3 Transactions which do not constitute transfer [Sections 46 and 47]

1.4.4 Year of chargeability to tax

1.5 Meaning of Capital Gain

1.5.1 Short-term Capital Gain

1.5.2 Long-Term Capital Gain

1.6 The method of computing capital gains.

1.7 Differences between Long term capital gains and Short term capital gains

1.8 Full value of consideration

1.9 Cost of Acquisition

1.10 Cost of Improvement

1.11 Cost Inflation Index

1.12 Exemption from Capital Gains

1.13 Income from Other Source

1.14 Interest on securities

1.14.1 Interest on Securities exempted from Tax. U/S 10(15)

1.15 Kinds of securities

1.16 Summary

1.17 Glossary

1.18 Self-Assessment Questions

1.19 Books Recommended

1.1 INTRODUCTION

The provisions for computation of Income from capital gains are covered under sections 45 to 55. Section 2(14) defines the term capital gain and section 45, the charging section lays down basis of charge for taxability of capital gain/loss arises on transfer of capital asset. Taxability of capital gain depends upon the nature of capital gain arises, i.e., short term capital gain or long term capital gain. The type of capital gain depends upon the period for which the capital asset is held. The taxability of capital gain shall satisfy the conditions like there should be capital asset, the asset is transferred by the assessee, such transfer takes place during the previous year, etc. To give relief to the assessee, the concept of exemption introduced under section 54, 54B, 54D, 54EC, 54F, 54G, 54GA, 54GB and 54H. Further this lesson will give some insight regarding the concept of ‘income from other sources’. Income chargeable under Income-tax Act, which does not specifically fall for assessment under any of the heads, must be charged to tax as “income from other sources”. This head is thus a residuary head of income under which income can be computed only after deciding whether the particular item of income is otherwise assessable under any of the first four heads. In addition to the taxation of income not covered by the other heads, Section 56(2) specifically provides certain items of incomes as being chargeable to tax under the head in every case. The provisions for computation of income from other sources are covered under sections 56 to 59. While section 56 defines the scope of income chargeable under this head, sections 57 and 58 specify the basis of computation of such income.

1.2 OBJECTIVES

At the end of this lesson, you will learn

- The conditions to be satisfied for income to be chargeable under this head,
- Which assets are classified as capital asset,
- The year in which the capital gains are chargeable to tax,
- Classification of capital gain into long term and short term,
- Which are the transactions not regarded as transfer,
- What are the exemptions available in respect of capital gains.
- Which are the income chargeable under the head income from other sources.
- What are admissible deductions.

1.3 CONCEPT OF CAPITAL GAINS

Profits or gains arising from the transfer of a capital asset made in a previous year are taxable as capital gains under the head “Capital Gains”. Sections 45 to 55A of the Income-tax Act, 1961 deal with capital gains. Section 45 of the Act, provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, 54GA and 54H be chargeable to income-tax under the head “Capital Gains” and shall be deemed to be the income of the previous year in which the transfer took place. Doubts may arise as to whether ‘Capital Gains’ being a capital receipt can be brought to tax as income. It may be noted that the ordinary accounting canons of distinctions between a capital receipt and a revenue receipt are not always followed under the Income-tax Act. Section 2(24)(vi) of the Income-tax Act specifically provides that “Income” includes “any capital gains chargeable under Section 45(1)”. It may not be out of place to mention here that in the absence of a specific provision in Section 2(24) capital gains have no logic to be taxed as income. The constitutional validity of the provisions of the Act relating to capital gains was challenged in *Navin Chandra Mafatlal v. C.I.T.* (1955) 27 ITR 245. The Supreme Court while upholding the competence of parliament in legislating with regard to capital gains as part of income, observed that the term income should be given the widest connotation so as to include capital gains

within its scope. However, all capital profits do not necessarily constitute capital gains. For instance, profits on re-issue of forfeited shares, profits on redemption of debentures, premium on issue of shares, 'pagri' from tenants etc. are capital profits and not capital gains, hence, not liable to tax. The capital gain is chargeable to income tax if the following conditions are satisfied:

1. There is a capital asset.
2. Assessee should transfer the capital asset.
3. Transfer of capital assets should take place during the previous year.
4. There should be gain or loss on account of such transfer of capital asset.

1.4 Capital Asset: Sec. 2(14): Capital Asset means property of any kind (Fixed, Circulating, movable, immovable, tangible or intangible) whether or not connected with business or profession. In other words property of any kind held by an assessee whether or not connected with his business or profession but does not include:

(i)Any stock-in-trade, consumable stores or raw-materials held for the purposes of his business or profession;

(ii)Personal effects that is to say, movable property (including wearing apparel and furniture but excluding jewellery) held for personal use by the assessee or any member of his family dependent on him. Jewellery includes ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel and precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;

(iii)Agricultural land in India, not being land situate (a) within the jurisdiction of a municipality or a cantonment board and which has a population of not less than 10,000, or (b) in any area within the distance, measured aerially, –

(I) not being more than two kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten thousand but not exceeding one lakh;
or

(II) not being more than six kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than one lakh but not exceeding ten lakh; or

(III) not being more than eight kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten lakh.

Explanation: – For the purposes of this sub-clause, "population" means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year;

(iv) **6½ per cent Gold Bonds, 1977 or 7 per cent Gold Bonds, 1980 or National Defence Gold Bonds, 1980** issued by the Central Government;

(v) **Special Bearer Bonds 1991** issued by the Central Government.

(vi) **Gold Deposit Bonds** issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

1.4.1 Kinds of capital assets

There are two kinds of capital assets

Short-term capital asset: Sec. 2(42A): means a capital asset held by an assessee for not more than thirty six months immediately preceding the date of its transfer. However, in the following cases, an asset, held for not more than twelve months, is treated as short-term capital asset—

a. Quoted or unquoted equity or preference shares in a company

b. Quoted Securities

c. Quoted or unquoted Units of UTI

d. Quoted or unquoted Units of Mutual Funds specified u/s. 10(23D)

e. Quoted or unquoted zero coupon bonds

Long-term capital asset: Sec. 2(29A): means a capital asset which is not a short-term capital asset. Under the existing law, profits and gains arising from the transfer of capital asset made in a previous year is taxable as capital gains. A capital asset is distinguished on the basis of the period of holding. A capital asset, which is held for more than three years, is categorized as a long-term capital asset. However, if the capital asset is in the nature of equity, it is categorized as a long-term capital asset if it is held for more than one year. All capital assets other than long-term capital asset are termed as a short-term capital asset.

1.4.2 Transfer of capital asset

Transfer includes:

- Sale of asset
- Exchange of asset
- Relinquishment of asset (means surrender of asset)
- Extinguishments of any right on asset (means reducing any right on asset)
- Compulsory acquisition of asset.

The definition of transfer is inclusive, thus transfer includes only above said five ways. In other words, transfer can take place only on these five ways. If there is any other way where an asset is given to other such as by way of gift, inheritance etc. it will not be termed as transfer.

1.4.3 Transactions which do not constitute transfer [Sections 46 and 47]

- (i) Any distribution of capital assets on the total or partial partition of a Hindu Undivided Family;
- (ii) any transfer of a capital asset under a gift or will or an irrevocable trust; Provided that this clause shall not apply to transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees' Stock Option Plan or Scheme of the company offered to such employees in accordance with the guidelines issued by the Central Government in this behalf;
- (iii) Any transfer of a capital asset by a company to its subsidiary company, if– (a) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and (b) the subsidiary company is an Indian company;

(iv) Any transfer of a capital asset by a subsidiary company to the holding company, if – (a) the whole of the share capital of the subsidiary company is held by the holding company, and (b) the holding company is an Indian company;

(v) Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company;

(vi) any transfer in a scheme of amalgamation of a capital asset being share or shares held in an Indian Company, by the amalgamating foreign company to the amalgamated foreign company, if –

(a) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and

(b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated (applicable from the assessment year 1993-94);

(viaa) any transfer in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government under Sub-section (7) of Section 45 of the Banking Regulation Act, 1949, of a capital asset by the banking company to the banking institution.

(vib) any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.

(vic) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if –

(a) the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated provided that the provisions of Sections 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demerger referred to in this clause.

(vid) any transfer or issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.

(vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if –

(a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholders itself is the amalgamated company, and

(b) the amalgamated company is an Indian company;

(viiia) any transfer of a capital asset of such foreign currency convertible bonds or Global Depository Receipts as are referred to in Section 115AC(1) held by a non-resident to another non-resident where the transfer is made outside India (applicable from 1.6.1992);

(viiib) any transfer of agricultural land in India effected before the first day of March, 1970;

(ix) any transfer of a capital asset being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States;

(x) any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company, into shares or debentures of that company.

(xi) any transfer made on or before 31.12.1998 by a person not being a company of a capital asset being membership of a recognised stock exchange to a company in exchange for shares allotted by that company to him (transferor).

(xii) any transfer of land by a sick industrial company made at any time beginning with declaration of it being sick by the BIFR and ending with the previous year in which its net worth wipes out the accumulated losses.

(xiii) where a firm is succeeded by a company in the business carried on by it as a result of which the firm sells or otherwise transfers any capital asset or intangible asset to the company: Any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of the demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company.

Provided that —

(a) all the assets and liabilities of the firm or of the association of persons or body of individuals relating to the business immediately before the succession become the assets and liabilities of the company,

(b) all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital account stood in the books of the firm on the date of succession.

(c) the partners of the firm do not receive any consideration or benefit, directly or indirectly in any form or manner, other than by way of allotment of shares in the company, and

(d) the aggregate of the share holding in the company of the partners of the firm is not less than fifty per cent of the total voting power in the company and their shareholding continue to be as such for a period of five years from the date of succession.

(e) the demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for corporatisation which is approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India Act, 1992.

(xiiia) any transfer of a capital asset being a membership right held by a member of a recognised stock exchange in India for acquisition of shares and trading or clearing rights acquired by such member in that recognised stock exchange in accordance with a scheme for demutualisation or corporatisation which is 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).

(xiiib) any transfer of a capital asset or intangible asset by a private company or unlisted public company (hereafter in this clause referred to as the company) to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership

1.4.4 Year of chargeability to tax

Capital gains are generally charged to tax in the year in which ‘transfer’ takes place.

1.5 MEANING OF CAPITAL GAIN

Any profits or gains arising from the transfer of a capital asset is called capital gain. Capital gain is an increase in the value of a capital asset (investment or real estate) that gives it a higher worth than the purchase price. The gain is not realized until the asset is sold. A capital gain may be short-term (one year or less) or long-term (more than one year) and must be claimed on incometaxes.

In other words, A capital gain refers to profit that results from a sale of a capital asset, such as stock, bond or real estate, where the sale price exceeds the purchase price. The gain is the difference between a higher selling price and a lower purchase price. Conversely, a capital loss arises if the proceeds from the sale of a capital asset are less than the purchase price.

Capital gains may also refer to a different form of profit received from an asset which refers to "investment income" in the form of cash flow or passive income that arises in relation to real assets, such as property; financial assets, such as shares/stocks or bonds; and intangible assets.

1.5.1 Short-term Capital Gain

Any capital gain arising as a result of transfer of a short-term capital asset is known as short-term capital gain. According to Section 2(42A) of the Income-tax Act: "Short term" capital asset means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. In the case of capital assets (being equity or preference share in a company) held by an assessee for not more than 12 months immediately prior to its transfer. In determining the period for which a capital asset is held by an assessee, the following must be noted:

(i) In the case of shares held in a company in liquidation, the period subsequent to the date on which the company goes into liquidation shall be excluded.

(ii) In case the asset becomes the property of the assessee under the circumstances mentioned in Section 49(1) – discussed later in this lesson - the period for which the asset was held by the previous owner shall be included.

(iii) In the case of the shares in an Indian Company which become the property of the assessee in a scheme of amalgamation, the period for which the shares in the amalgamating company were held by the assessee shall be included.

(iv) In the case of a capital asset, being a share or any other security subscribed to by the assessee on the basis of his right to subscribe to such financial asset or subscribed to by the person in whose favour the assessee has renounced his right to subscribe to such financial asset, the period shall be reckoned from the date of allotment of such financial asset;

(v) In the case of a capital assets, being the right to subscribe to any financial asset, which is renounced in favour of any other person, the period shall be reckoned from the date of the offer of such right by the company or institution, as the case may be, making such offer.

(vi) In the case of a capital asset, being a financial asset, allotted without any payment and on the basis of holding of any other financial asset, the period shall be reckoned from the date of the allotment of such financial asset.

(vii) In the case of a capital asset, being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, there shall be included the period for which the share or shares held in the demerged company were held by the assessee.

(viii) In the case of a capital asset, being trading or clearing rights of a recognized stock exchange in India acquired by a person pursuant to demutualisation or corporatisation of the recognized stock exchange in India as referred to in Clause (xiii) of Section 47, there shall be included the period for which the person was a member of the recognized stock exchange in India immediately prior to such demutualisation or corporatisation;

(viiiia) In the case of a capital asset, being equity share or shares in a company allotted pursuant to demutualisation or corporatisation of a recognised stock exchange in India as referred to in Clause (xiii) of Section 47, there shall be included the period for which the person was a member of the recognized stock exchange in India immediately prior to such demutualisation or corporatisation;

1.5.2 Long term capital gains

Any capital gain arising as a result of transfer of a long-term capital asset is known as long-term capital gain. Long term Capital gains are computed by deducting from the full value of consideration for the transfer of a capital asset the following:

- Expenditure connected exclusively with the transfer;
- The indexed cost of acquisition of the asset, and

- The indexed cost of improvement, if any, of that asset.

1.6 The method of computing capital gains

| Short-term Capital Gain | Long-term Capital Gain |
|--|--|
| A. Find out Full Value of Consideration | A. Find out Full Value of Consideration |
| B. Deduct | B. Deduct |
| (i) Expenditure incurred wholly and exclusively in connection with such Transfer. (ii) Cost of Acquisition (iii) Cost of Improvement (iv) Exemption provided by Ss. 54B, 54D & 54G,54GA | (i) Expenditure incurred wholly and exclusively in connection with such Transfer. (ii) Indexed Cost of Acquisition (iii) Indexed Cost of Improvement (iv) Exemption provided by Ss. 54, 54B, 54D, 54EC, 54ED, 54F & 54G, 54GA |
| C. (A-B) is the short-term capital gain | C. (A-B) is the long-term capital gain |

1.7 Differences between Long term capital gains and Short term capital gains

| Long Term Capital Gain | Short Term Capital Gain |
|---|---|
| It arises out of transfer of long term capital assets | It arises out of transfer of short term capital assets |
| Tax rate is 20% | Rates applicable to all other incomes |
| Cost of acquisition and cost of improvement are indexed on the basis of CII. | No indexing is done. |
| If LTCA is acquired before 1-4-1981, then the fair market value of the asset as on 1-4-1981 is taken as the value of acquisition. | No such option is available to STCA |
| Long term capital loss can be set off only against long term capital gain. | Short term capital loss can be set off against short term capital gain or long term capital gain. |

1.8 FULL VALUE OF CONSIDERATION

Full value of consideration means the whole or complete sale price or exchange value or compensation including enhanced compensation received in respect of capital asset in transfer. The following points are important to note in relation to full value of consideration.

1. The consideration may be in cash or kind.
2. The consideration received in kind is valued at its fair market value.
3. It may be received or receivable.
4. The consideration must be actual irrespective of its adequacy.

When shares, debentures or warrants are received under employees stock option plan or scheme are transferred under a gift or an irrecoverable trust, the market value on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer for computation of capital gains.

1.9 COST OF ACQUISITION

Cost of Acquisition (COA) means any capital expense at the time of acquiring capital asset under transfer, i.e., to include the purchase price, expenses incurred up to acquiring date in the form of registration, storage etc. expenses incurred on completing transfer. In other words, cost of acquisition of an asset is the value for which it was acquired by the assessee. Expenses of capital nature for completing or acquiring the title are included in the cost of acquisition.

➤ **Cost to the previous owner deemed to be the cost of acquisition:** If the asset is acquired by an assessee in the *following* circumstances the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it.

1. On any distribution of asset on the total or partial partition of a HUF or
2. Under gift or will
3. By succession, inheritance or devolution or
4. On any distribution of assets on the dissolution of a firm, body of individuals or other association of persons at any time before 1-04-1987. Or

5. On Any distribution of asset on the liquidation of a company or
6. Under a transfer to a revocable or an irrevocable trust or
7. On transfer by a parent company to its Indian subsidiary company which is wholly owned by a parent company or
8. On the transfer by a subsidiary company to its Indian holding company which owns whole of the share capital of the subsidiary company or
9. On the transfer of capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company. Or
10. On transfer of shares of an Indian company by amalgamated foreign company to the amalgamated foreign company. Or
11. On the transfer of capital asset in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the central government or
12. When any members of HUF converts his self acquired property into HUF property or
13. On transfer of capital asset by the predecessor cooperative bank to the successor cooperative bank in a business organization or
14. On transfer of shares in the predecessor cooperative bank in lieu of shares allotted in the successor cooperative bank in a business reorganization or
15. On transfer of capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company or
16. On succession of a sole proprietary concern by a company.

- **Cost of share or security** If the share or security was acquired before 1st April 1981, the cost of acquisition will be the actual cost or fair market value on 1st April 1981 whichever is beneficial to the assessee. If it is acquired after 31st march 1981, the actual cost is the cost of acquisition.
- **Cost of bonus shares** The cost of bonus shares or security which is received by the assessee without any payment on the basis of his holding any financial asset will be as under (a) Where bonus share or security was received prior to 1st April 1981, the fair market value on 1str April 1981. (b) In any other case- nil

- **Cost of acquisition of goodwill** If the asset is purchased from the previous owner – purchase price In any other case – Nil
- **Right issue**-cost of acquisition in the case of right issue is amount actually paid to acquire it.
- **Capital asset acquired before 1st April 1981**- total cost of the asset to the assessee or the faire market value on 1st April 1981.
- **Capital asset acquired by the previous owner before 1st April 1981**- total cost of the asset to the previous owner or the faire market value on 1st April 1981.
- **Cost of acquisition of shares or debentures**- shares or debentures acquired in consideration of conversion of debenture, debenture stock or deposit certificate shall be deemed to be the cost of original debentures, debenture stocks or deposit certificates converted.

Cost of acquisition shall have to be adjusted by the Cost Inflation Index to arrive at the indexed cost of acquisition, as follows:

For assets acquired before 1.4.1981 by the assessee

Cost of Acquisition or fair market value of the asset as on 1.4.1981

x

Indexed Cost of acquisition = Cost Inflation Index for the financial year in which the asset is transferred

(Cost Inflation Index for 1981-82)

Cost of improvement x Cost Inflation Index

Indexed Cost of Acquisition = _____

(Cost Inflation Index for 1981-82)

For assets acquired by the assessee on or after 1.4.1981

Cost Inflation index for the year in which the

Indexed cost of acquisition = cost of acquisition x asset is transferred

Cost Inflation Index for the first year in which the

asset is acquired by the assessee

1.10 COST OF IMPROVEMENT

Cost of improvement is the capital expenditure incurred by an assessee for making any addition or improvement in the capital asset. It also includes any expenditure incurred in protecting or curing the title. In other words, cost of improvement includes all those expenditures, which are incurred to increase the value of the capital asset.

Cost of improvement x CII for the year in which the asset is sold

Indexed Cost of improvement = -----

CII for the year in which the improvement to asset took place.

Any cost of improvement incurred before 1st April 1981 is not considered or it is ignored. The reason behind it is that for carrying any improvement in asset before 1st April 1981, asset should have been purchased before 1st April 1981. If asset is purchased before 1st April we consider the fair market value. The fair market value of asset on 1st April 1981 will certainly include the improvement made in the asset.

1.11 COST INFLATION INDEX SPECIFIED FOR PURPOSE OF COMPUTATION OF CAPITAL GAIN

In exercise of the powers conferred by clause (v) of the Explanation to Section 48 of the Income-tax Act, 1961 (43 of 1961), the Central Government; having regard to seventy-five per cent of the average rise in the Consumer Price Index for urban non-manual employees, has specified the Cost Inflation Index as mentioned in column (3) of the Table below for the financial year mentioned in the corresponding entry in column (2) of the said Table.

| Sl. No. | Financial year | Cost Inflation Index |
|----------------|-----------------------|-----------------------------|
| (1) | (2) | (3) |
| 1. | 2000-01 | 100 |
| 2+. | 2001-02 | 105 |
| 3. | 2002-03 | 109 |
| 4. | 2003-04 | 113 |
| 5. | 2004-05 | 117 |
| 6. | 2005-06 | 122 |
| 7. | 2006-07 | 129 |
| 8. | 2007-08 | 137 |
| 9. | 2008-09 | 148 |
| 10. | 2009-10 | 167 |
| 11. | 2010-11 | 184 |
| 12. | 2011-12 | 184 |
| 13. | 2012-13 | 200 |
| 14. | 2013-14 | 220 |
| 15. | 2014-15 | 240 |
| 16. | 2015-16 | 254 |
| 17. | 2016-17 | 264 |
| 18. | 2017-18 | 272 |
| 19. | 2018-19 | 280 |
| 20. | 2019-20 | 289 |
| 21. | 2020-21 | 301 |

Computation of capital gains in case of slump sale: Any gain arising from the slump sale effected in the previous year shall be chargeable as long term capital gains of the previous year in which the transfer take place.

Expenditure on transfer

Expenditure incurred wholly and exclusively for transfer of capital asset is called expenditure on transfer. It is fully deductible from the full value of consideration while calculating the capital gain. Examples of expenditure on transfer are the commission or brokerage paid by seller, any fees like registration fees, and cost of stamp papers etc., travelling expenses, and litigation expenses incurred for transferring the capital assets are expenditure on transfer.

Note: Expenditure incurred by buyer at the time of buying the capital assets like brokerage, commission, registration fees, cost of stamp paper etc. are to be added in the cost of acquisition before indexation.

1.12 EXEMPTION FROM CAPITAL GAINS

- **Capital gain arising on the transfer of property used for residence u/s 54:** The exemption u/s 54 relates to the capital gain arising out of transfer of residential house. The exemption is available to only Individual assessee. The exemption relates to the capital gains arising on the transfer of a residential house. Conditions: Exemption is available if:

1. House Property transferred was used for residential purpose.
2. House Property was a long term capital asset.
3. Assessee has purchased another house property within a period of one year before or two years after the date of transfer or has constructed another house property within three years of date of transfer i.e. the construction of the new house property should be completed within three years. The date of starting of construction is irrelevant. Where the amount of capital gain is not utilized by the assessee for acquisition of new house before the due date, it shall be deposited by him on or before the due date of furnishing the return of income in an account opened under the capital gain account scheme 1988.

Amount of Exemption will be the least of:

1. Capital Gain
2. Cost of new house. **Withdrawal of exemption:** If the newly acquired house property is transferred within three years of acquisition. Thus the earlier exempted capital gain will be charged to tax in the year in which the newly acquired house property is transferred. For that the cost of acquisition of the newly acquired house property will be reduced by the amount of exemption already availed thus the cost will reduce and thus the capital gains on the new house property will

be more. Above all the new house property will be a STCA since for withdrawal of exemption it should have been sold within three years of its acquisition thus now the capital gain of the new house property will be STCG which is charged as per the normal rates which may be 30% (a higher rate as compared to the flat rate of LTCG of 20%) in the case of individuals.

- **Capital gain arising from the transfer of agricultural land (sec 54 B):** Any capital gain arising on the transfer of agricultural land situated in an urban area is exempt subject to the following conditions

1. The agriculture land is owned by an individual or a HUF
2. The agriculture land was in the two years immediately preceding the date of transfer, being used either by the assessee or his parent or HUF for agriculture purposes.
3. The assessee has purchased within a period of two years from the date of transfer any other land for agricultural purposes. The amount of deduction is the capital gain arising from the transfer of such agricultural land is exempt to the extent of the cost of the new agricultural land purchased within two years from the date of transfer. If the amount of capital gain is not utilized by the assessee for the acquisition of the new agricultural land before due date of furnishing return of income, it shall be transferred to capital gain account scheme. The exemption is withdrawn if the assessee transfers the new land within 3 years of its purchase.

- **Capital gain on compulsory acquisition of land and buildings (sec 54 D):** This exemption is available to all categories of taxpayers. To get exemption the following conditions are to be satisfied.

1. The asset transferred is land or building or any right in land or building which formed part of new industrial undertaking belonging to the tax payer.
2. Asset in question is transferred by way of compulsory acquisition under any law.
3. The asset in question was used for the purpose of industrial undertaking at least for two years immediately before the date of compulsory acquisition.
4. Assessee has purchased any other land or building within a period of three years from the date of receipt of compensation or constructed a building within such a period.

If the new asset is not acquired by the due date for furnishing the return of income for the relevant assessment year, the unutilized amount of capital gains must be deposited in a Capital Gains Deposit Account. The cost of acquisition of the new asset is reduced by the exemption granted from LTCG for a period of 3 years from its date of acquisition.

- **Investment in Financial Assets (Section -54 EC):** This exemption is available to all categories of taxpayers. To get exemption the following conditions are to be satisfied.

1. The assessee should transfer a long-term capital asset during the previous year.
2. The assessee should invest the whole or part of capital gain in long term specified assets. The long term specified assets include
 - I. Bonds redeemable after three years
 - II. Issued on or after 1.4.2007 and
 - III. Issued by
 - a) National Highway Authority of India (NHAI). Or
 - b) Rural Electrification Corporation Limited (RECL).

The investment made on or after 1.4.2007 in the long term specified asset by an assessee during any financial year shall not exceed fifty lakh rupees. The investment is to be made within six months from the date of transfer of the original capital asset. The bonds should not be transferred or converted into money for a period of three years from the date of acquisition. In case the bonds are transferred within 3 years from the date of their acquisition, the exemption allowed for investment earlier would be taxed in the year of such transfer as capital gains. For this purpose it would be considered as transfer even if the assessee takes any loan or advance on the security of the specified securities. For the investment in the bonds deduction under section 80C will not be available.

- **Investment into a residential house (Section 54F):** If an individual or a HUF having LTCG arising out of sale of capital asset other than a residential house invests in the purchase or construction of a residential house, then, he/it is eligible for exemption.

Cost of New House X Capital Gains

Amount of exemption = -----

Net Consideration

Where net consideration = full value of consideration - cost of transfer.

The time available for investment and the method to be followed for investment after the due date for filing of return of income are the same as mentioned in the scheme in (a) above. In this case, however, cost of the new asset is not changed. But the assessee should not own more than one residential house other than the residential house in which he has invested as on the date of transfer and also, he should not purchase/construct any other residential house for a period of 1/3 years from the date of transfer. In case he owns more than one residential house as on the date of transfer he is not eligible for this deduction. In case he purchases/constructs a house within 1/3 years from the date of transfer after getting this deduction, the amount allowed as deduction would be taxed as capital gains in the year of such purchase/construction.

1.13 INCOME FROM OTHER SOURCE

“Income from other sources” is the fifth and last head of income included while computing the gross total income of an assessee. Under the Income Tax act, income of every kind which is not to be excluded from the total income shall be chargeable to income tax under the head 'Income from other sources', if it is not chargeable to income tax under any of the other heads of income. Thus, income from other sources is a residuary head of income i.e. income not chargeable under any other head is chargeable to tax under this head. All income other than income from salary, house property, business and profession or capital gains is covered under 'Income from other sources'

Section 56, 57, 58 and 59 of the Income Tax Act deal with the computation of income under this head.

According to section 56 (1), every kind of income which is included in the total income under this Act and which is not charged to tax under any first four heads specified in section 14 is chargeable to income-tax under the head “ Income from Other Sources”.

1.13.1 There are two types of income included in this head

- General Incomes covered under section 56(1), and
- Specific Incomes covered under section 56(2).

General Incomes section 56 (1) as ‘Income from Other Sources’

- 1) Income earned by the assessee from licenses granted to brick-makers, to erect brickkilns upon his land and making use of the brick-earth for making bricks.
- 2) Interest on loans, securities, deposits, cooperative debentures and current accounts.
- 3) Income from agriculture land situated outside India.
- 4) Income derived by a coal mine owner from rent and royalties.
- 5) Any withdrawal from the National Saving Scheme up to an amount on which deduction under section 80CCA has been claimed.
- 6) Remuneration received for being as a director, not as employee.
- 7) Income received from a person other than the employer like University remuneration.
- 8) Family pension received by the legal heirs of employee.
- 9) Income received by a professional man as a university examiner.
- 10) Income received from sub-letting of house.
- 11) Remuneration from lectures delivered outside India.
- 12) Tips received by a waiter or taxi driver not from their employer.
- 13) Any amount or pension received from LIC or other insurer under section 80CCC.
- 14) Deemed incomes.
- 15) Income from writing articles by a non-journalist.
- 17) Gratuity received by a non-employee director.
- 18) Commission received by an agent of Life Insurance Corporation, Postal Savings, Unit Trust of India or other type of mutual funds if it is not his regular business.
- 19) Commission received by a director for standing as a guarantor.
- 20) Commission received by a director for under writing the shares of a new company.

Specific Incomes section 56 (2) as 'Income from Other Sources'

- 1) Any winning from lotteries, crossword puzzles, races including horse races, car games or any other games or from gambling or betting of any form or natural.
- 2) Dividends (except dividend covered u/s 115-O).
- 3) Income from plant, machinery or furniture let on hire, provided such income is not charged to tax under the head 'profits and Gains of Business or Profession'.
- 4) Any sum received by the assessee from his employees as contribution to any provident fund or superannuation fund or any fund set up under provisions of the Employees State Insurance Act 1948, or from any other fund from the welfare of such employees, provided such income is not charged to tax under the head 'Profits and Gains of Business or Profession'.
- 5) Income received in the form of interest on securities, provided such income is not charged to tax under the head 'Profits and Gains of Business or Profession'.
- 6) Income from let-out of building along with plant, machinery or furniture and letout of building is inseparable from such plant, machinery or furniture, provided income from such let-out is not charged to tax under the head 'Profits and Gains from Business or Profession'.
- 7) Any sum or bonus received from key man insurance policy if such sum is not chargeable to tax as salary or bonus income.
- 8) Any sum of money received without consideration by an individual or HUF, the aggregate value of which exceeds Rs.50, 000, from any person on or after 1 April 2006 but before 1 October 2009. The whole amount will be charged to tax under the head 'Income from Other Sources'.
- 9) Income received by in the form of interest on compensation or on enhanced compensation.
- 10) Any consideration received by a closely held company for the issue of shares that exceeded the face value of such shares.
- 11) Any sum received as an advance or otherwise in the course of negotiation for the transfer of a capital asset and such amount is forfeited due to non transfer of such capital asset.
- 12) if a firm or closely held company receives any property in the form of shares of a closely held company in any previous from any person: a) Without any consideration, the aggregate fair market value of which exceeds Rs.50,000, such aggregate fair market value of shares shall be taxable under

the head 'Income from Other Sources'. b) For a consideration which is less than the fair market value of such shares by an amount exceeding Rs. 50000, the excess of aggregate fair market value of such shares over such consideration shall be taxable under the head 'Income from Other Sources'.

13) The treatment of Gifts by an Individual or HUF:

a) Any sum of money received by an individual or HUF from any person without consideration exceeds Rs.50000 in aggregate during the previous year, whole of such amount shall be chargeable to tax under the head 'Income from other sources'.

b) Immovable property:

(i)- Any immovable property received by an individual or HUF from any person without any consideration having stamp duty exceeding Rs.50000, the stamp duty value shall be taxable under the head 'Income from other sources'.

(ii)- Any immovable property received by an individual or HUF on or after 1 April 2014 for a consideration which is less than the stamp duty value of such property by an amount exceeding Rs. 50000, the stamp duty value of such property as exceeding such consideration is taxable under the head 'Income from other sources'.

c) Other than Immovable Property;

(i)- Property other than immovable property received by an individual or HUF from any person without any consideration, the aggregate fair market value of which exceeds Rs.50000, whole of the aggregate fair market value of such property shall be taxable under the head 'income from other sources'.

(ii)- Property other than immovable property received by an individual or HUF from any person for a consideration, which is less than the aggregate fair market value of the property by an amount exceeding Rs. 50000, the excess of aggregate fair market value of such property over such consideration is taxable under the head 'Income from other sources'.

1.14 INTEREST ON SECURITIES

The income from interest on securities shall be chargeable to tax under income from other sources, if it is not taxable under the head income from business or profession. The following amounts due to an assessee in the previous year shall be chargeable to income tax as interest on securities.

1. Interest on any security of the central or state govts.
2. Interest on debentures or other securities issued by a local authority.
3. Interest on debentures issued by a company (whether Indian or foreign)
4. Interest on debentures or other securities issued by statutory corporation.

(i)- Interest on securities due to an assessee provided by the Central or the State Govt. shall be chargeable to tax under interest on securities.

(ii)- Interest on debentures or other securities for money issued or on the behalf of a local authority or a company or a corporation established by the Central, State or Provincial Act shall be charged to tax under interest on securities.

(iii)- Tax treatment of Interest:

- Any interest which accrues to a person during the previous year is added to his gross total income.
- Interest is taxable on due basis whether received or not.
- Interest on securities issued by the Govt. of India is considered to be accrued in India even if enforced to pay outside India.
- Interest accrues on the name of the person on whose name securities stand on the date of accrual of interest.

Deduction of Tax at source. It is the duty of the security issuing authority to deduct tax at source before making the payment of interest on securities at the prescribed rate. (Section 193)

1. No TDS in case of Interest on Debentures (section 193), if certain conditions are fulfilled, these are:

- (i) Debentures are issued by a company in which the public are substantially interested.
- (ii) Interest is paid to a resident debenture holder.
- (iii) Debentures are listed on a recognized stock exchange.

(iv) Interest is paid through account payee cheque.

(v) The amount of interest does not exceed Rs. 5000, payable in a financial year.

2. Commission on Sale of Securities:

(i) Any amount of commission or other form incurred by the assessee in case of purchase or sale of securities is not allowable deduction out of the income of interest on such securities.

(ii) Any amount of commission paid at the time of purchase of securities are included in the cost of these securities and any commission paid on the sale of such securities are allowed to be deducted out of the selling price of these securities.

1.14.1 Interest on Securities exempted from Tax. U/S 10(15)

A. Interest on certain type of Bonds issued by public sector companies/undertakings has been exempted from tax, these are:

1. 7% capital investment bonds.

2. 10% secured redeemable NTPC bonds 1986. (Ist series)

3. 9% and 10% secured redeemable non-convertible bonds issued by Indian Railway Finance Corporation.

4. 10% secured redeemable non-convertible bonds issued by Mahanagar Telephone Nigam Ltd.

5. 10% secured redeemable non-convertible bonds 1987 (B series) issued by National Hydro Electric Power Corporation Ltd.

6. 9% (Tax free) secured redeemable bonds issued by Power Finance Corporation Ltd.

7. 6.5%, 8%, 9%, and 10% National Relief Bonds.

8. 10% (Tax free) secured redeemable non-convertible bonds issued by Indian Telephone Industries Ltd.

9. 10-years 9% (Tax free) secured redeemable non-convertible PFC bonds- II series (private

placement) issued by issued by Power Finance Corporation.

10. 10-years 9% (Tax free) secured redeemable non-convertible NTPC bonds-IV issue (private placement).

11. 10-years 9% (Tax free) secured redeemable non-convertible REC bonds issued by the Rural Electrification Corporation Ltd.

12. 10-years 9% (Tax free) secured redeemable non-convertible (C series) issue by Neyveli Lignite Corporation Ltd.

B. Interest on Securities exempted from Tax.

- Interests on securities earned by the following types of assesseees are exempted from tax.

1) Political parties.

2) A local authority.

3) A registered trade union.

4) Trustees of a recognized provident fund.

5) An approved scientific research association.

6) Members of scheduled tribes living in tribal areas.

7) A non-resident of Indian origin and securities and bonds were issued before June 1, 2002.

8) Public charitable and religion trusts.

1.15 KINDS OF SECURITIES

There are four types of securities.

1. Tax free government securities: The interest on these securities is fully exempt from tax. The interest on such securities is neither included in total income nor taxed.

2. Less tax government securities: These securities are issued by central govt or state government. These securities are taxable securities. But no tax is deducted at source on such securities. Therefore the interest on such securities will not be grossed up.

3. Tax free commercial securities: These securities are issued by local authority or Statuary Corporation or a company in the form of debentures or bonds. Actually the interest is not tax free. Income tax due on this interest is payable by the company or authority or Statuary Corporation. These are called tax free because the assessee is not required to pay tax on it. The interest due to an assessee is grossed up and this grossed up amount is included in the total income.

4. Less tax commercial securities: These are taxable securities. In this case income tax is deducted at source on the amount of interest calculated at the percentage stated on the securities. In this type of securities, if the net amount of interest is given, it has got to be grossed up. If the rate of percentage of interest is given it is not grossed up.

Bond washing transaction

A bond-washing transaction is a transaction where securities are sold sometime before the due date of interest and reacquired after the due date is over. This practice is adopted by persons in the higher income group to avoid tax by transferring the securities to their relatives/friends in the lower income group just before the due date of payment of interest. In such a case, interest would be taxable in the hands of the transferee, who is the legal owner of securities. In order to discourage such practice, section 94(1) provides that where the owner of a security transfers the security just before the due date of interest and buys back the same immediately after the due date and interest is received by the transferee, such interest income will be deemed to be the income of the transferor and would be taxable in his hands. In order to prevent the practice of sale of securities-cum-interest, section 94(2) provides that if an assessee who has beneficial interest in securities sells such securities in such a manner that either no income is received or income received is less than the sum he would have received if such interest had accrued from day to day, then income from such securities for the whole year would be deemed to be the income of the assessee.

1.16 SUMMARY

Any income arising from the transfer of a capital asset in the relevant previous year shall be chargeable to income tax under the head 'Capital Gains' and shall be deemed to be the income of the previous year

in which transfer of asset takes place. It means tax is to be levied on any profit or gain occurring on the transfer of a capital asset. The term capital assets includes all types of properties, whether tangible or intangible, movable or immovable, fixed or floating. Further two types of capital assets are there: Short term capital assets and long term capital assets. If the assessee holds the capital asset up to 36 months, then asset is considered as long term whereas, if the assessee holds the capital asset up to less than 26 months, then asset is considered as short term. The gain from capital asset arises only on its transfer. If the asset transferred is not a capital asset, then no capital gain shall arise. The transfer includes, sale, exchange or relinquishment of the capital assets; or the extinguishment of any rights therein; or the compulsory acquisition thereof under any law. In other words long and short term gains arise only when there is transfer of an asset. Any capital gain arising as a result of transfer of a short-term capital asset is known as short-term capital gain whereas any gain arising as a result of transfer of long-term capital asset is known as long term capital gain. In addition, the value for which the asset was acquired by the assessee is known as the cost of acquisition. In other words Cost of Acquisition (COA) means any capital expense at the time of acquiring capital asset under transfer, i.e., to include the purchase price, expenses incurred up to acquiring date in the form of registration, storage etc. expenses incurred on completing transfer. Expenses of capital nature for completing or acquiring the title are included in the cost of acquisition. Further if the assessee makes any addition or improvement in the capital asset as an addition over and above the cost of acquisition such cost or capital expenditure is termed as Cost of improvement. It also includes any expenditure incurred in protecting or curing the title. In other words, cost of improvement includes all those expenditures, which are incurred to increase the value of the capital asset. The assessee has been provided the opportunity by the Act to avail tax deduction arising out of capital gains by way of many specific sections. Under Sections 54, 54B, 54D, 54EC, 54F, 54G and 54H of the Act, capital gains arising from the transfer of certain capital assets are exempt from tax under certain circumstances.

Under the Income Tax act, income of every kind which is not to be excluded from the total income shall be chargeable to income tax under the head 'Income from other sources', if it is not chargeable to income tax under any of the other heads of income. Thus, income from other sources is a residuary head of income i.e. income not chargeable under any other head is chargeable to tax under this head. All income other than income from salary, house property, business and profession or capital gains is covered under 'Income from other sources'. Two types of income are included in this head, General Incomes covered under section 56(1), and Specific Incomes covered under section 56(2).

Lastly we have discussed some issues related interest on securities. The income from interest on securities shall be chargeable to tax under income from other sources, if it is not taxable under the head income from business or profession. The following amounts due to an assessee in the previous year shall be chargeable to income tax as interest on securities. Interest on any security of the central or state govts, Interest on debentures or other securities issued by a local authority, Interest on debentures issued by a company (whether Indian or foreign), Interest on debentures or other securities issued by statutory corporation. Interest on Securities is exempted from Tax. U/S 10(15).

ILLUSTRATION I

Mr. R held the following Investments:

- a) Rs 9000 10% (tax-free) Debentures of a listed company (rate of TDS 10%)
- b) Rs 100000 12% Punjab govt. loan.

Compute his income from interest on securities for the year ending 31-3-2021

SOLUTION

Computation of Income from interest on securities

| | Rs |
|---|-----------|
| a) Rs 90,000 10% (tax free) Debentures (listed) [9000 x 100/90] | 10,000 |
| b) Rs 100000 12% Punjab Govt. Loan | 12,000 |
| Income from Interest on securities | 22,000 |

ILLUSTRATION II

Calculate income from other source from information given below:

- i) Winning from lottery
- ii) Amount received from race winnings

Gifts received during the previous year 2020-21

- i) Received Rs 20000 gift from his friend
- ii) Received Rs 100000 as gift from his elder brother
- iii) Received Rs 140000 as gift on his marriage
- iv) Received 80000 as gift from his NRI friend on 1.1.206
- v) Another gift of Rs 18000 received from his cousin

SOLUTION

Computation of income from other source

| Income | Rs | Rs |
|---|-----------------|-----------------|
| i) Winning from lottery | | 100000 |
| ii) Amount received from race winning | | 50000 |
| to be grossed up [$35000 \times 100/70$] | | |
| Gifts Received | | |
| i) Received Rs 20000 gift from his friend | 20000 | |
| ii) Received Rs 100000 as gift from his elder brother | Nil | |
| (Gifts from relatives are exempted) | | |
| iii) Received Rs 140000 as gift on his marriage | Nil | |
| (Gifts from marriage are exempted) | | |
| iv) Received 80000 as gift from his NRI friend on 1.1.206 | 80000 | |
| v) Another gift of Rs 18000 received from his cousin | 18000 | 1,18,000 |
| Income from other sources | <u>2,68,000</u> | <u>1,18,000</u> |

1.17GLOSSARY

- Sections 45 to 55A of the Income-tax Act, 1961 deal with capital gains. Section 45 of the Act, provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, 54GA and 54H be chargeable to income-tax under the head “Capital Gains” and shall be deemed to be the income of the previous year in which the transfer took place.
- Section 2(14) of the Income-tax Act defines the term “capital asset” to mean Property of any kind held by an assessee whether or not connected with his business or profession but does not include any stock-in-trade, personal effects, agricultural land in India, 6½ per cent Gold Bonds, Special Bearer Bonds, Gold Deposit Bonds.
- The essential requirement for the incidence of tax on capital gains is the transfer of a ‘capital asset’. Any capital gain arising as a result of transfer of a short-term capital asset is known as short-term capital gain. “Short term” capital asset means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. In the case of capital assets (being equity or preference share in a company) held by an assessee for not more than 12 months immediately prior to its transfer.
- Assets other than short-term capital assets are known as ‘long-term capital assets’ and the gains arising therefrom are known as ‘long-term capital gains’. Section 48 of the Act provides that the income chargeable under the head ‘capital gains’ shall be computed by deducting from the full value of consideration received or accruing as a result of the transfer of the capital asset the amount of expenditure incurred wholly and exclusively in connection with such transfer and the cost of acquisition of the capital asset and the cost of any improvement thereto.
- ‘Cost of acquisition’ of goodwill of a business or a right to manufacture, produce or process any article or thing, tenancy rights, stage carriage permits or lorry hours is in the case of acquisition of such asset by the assessee by purchase from a previous owner, cost of acquisition means the amount of the purchase price; and in any other case cost of acquisition shall be Nil.
- Cost of improvement means all capital expenditure in making any additions or alterations by the assessee after it became his property and where the capital asset became the property of the

assessee by any of the modes specified in Section 49(1) by the previous owner as the case may be.

- Under Sections 54, 54B, 54D, 54EC, 54F, 54G and 54H of the Act, capital gains arising from the transfer of certain capital assets are exempt from tax under certain circumstances.
- Income chargeable under Income-tax Act, which does not specifically fall for assessment under any of the heads discussed earlier, must be charged to tax as “income from other sources”.
- Section 56(2) specifically provides for the certain items of incomes as being chargeable to tax under the head such as Dividend, Keyman Insurance policy, Winnings from lotteries, Contribution to Provident fund, Income by way of interest on securities, Income from hiring machinery etc, Hiring out of building with machinery, Money Gifts, Share premiums in excess of the fair market value to be treated as income, income by way of interest received on compensation.
- The entire income of winnings, without any expenditure or allowance or deductions under Sections 80C to 80U, will be taxable. However, expenses relating to the activity of owning and maintaining race horses are allowable. Further, such income is taxable at a special rate of income-tax i.e., 30% + surcharge + cess @ 3%.
- Admissible Deductions : The income chargeable under the head “Income from other sources” is the income after making the deductions such as
 - sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such interest;
 - deduction shall be allowable in accordance with the provisions of Section 36(1)(va), i.e., if the employer has credited the employee’s accounts in the respective funds;
 - a sum equal to 33-1/3% of the income or ` 15,000, whichever is less, is allowable as a deduction from family pension;
 - a deduction of a sum equal to 50% of from Interest on compensation or enhanced compensation, and
 - any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income.
- Inadmissible deductions: The following amounts shall not be deducted in computing income chargeable under the head ‘Income from other sources’:
 - Any personal expenses of the assessee.

- Any interest chargeable under the Income-tax Act which is payable outside India and from which income-tax has not been paid or deducted at source.
- Any payment which is chargeable under the head “Salaries” if it is payable outside India unless tax has been paid thereon or deducted therefrom at source.
- Any expenditure referred to in Section 40A of Income-tax Act.
- The basis of charge on income by way of interest on securities is on “receipt” basis if books of account are maintained on cash basis. If the assessee does not maintain books of account or, when he maintains books of account on the basis of “mercantile system”, it is taxable on “due” basis.

1.18 SELF ASSESSMENT QUESTIONS

1. What do you mean by “Capital Gain”?

2. Difference between Long-term Capital Gain and Short –Term Capital Gain .

3. Explain with the help of suitable illustration how capital gains are computed under section 45(2) in case of conversion of capital asset into stock-in-trade.

4. What is Cost of Acquisition and Cost of Improvement?

5. What are the incomes chargeable under the head “Income from other sources”?

6. What deductions are allowed under the head “Income from other sources”?

7. What are 'capital assets'? What items are not included in capital assets?

8. Explain the deduction given in respect of certain incomes.

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9. Explain Specific Income. What are the items to be included under general and Specific Income?

1.19 BOOKS RECOMMENDED

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. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.
4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.
5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.
6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.
7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

**SETT OFF AND CARRY FORWARD OF LOSSES, AGGREGATION OF INCOME,
DEDUCTIONS FROM GROSS TOTAL INCOME FOR INDIVIDUALS, HUF'S AND FIRMS.**

STRUCTURE:

2.1 Introduction

2.2 Objective

2.3 Concept of set-off and carry-forward of losses

2.3.1 Set-off of Losses

2.3.2 Carry-forward of Losses

2.4 Aggregation of Income

2.4.1 Income of other persons to be included in the income of individual (Section 60-645).

2.4.2 Income received from firm assessed as firm and Association of Persons (Section 66 & 67).

2.4.2 Deemed Incomes (Section 68-69).

2.5 Deductions from Gross Total Income

2.5.1 Deduction in respect of certain payments (section 80C to 80GGC).

2.5.2 Deduction in respect of certain incomes (section 80IA to 80U).

2.6 Summary

2.7 Glossary

2.8 Self-Assessment Questions

2.9 Books Recommended

2.1 INTRODUCTION

This lesson discusses the provisions for set-off and carry forward of losses. Sometimes the assessee incurs a loss from a source of income and unless such loss is set-off against any income, the net result of the assessee's activities during the particular accounting year cannot be ascertained and consequently the tax payable would also be incapable of determination. For this purpose, the Income-tax Act contains specific provisions (Sections 70 to 80) for the set-off and carryforward of losses.

This lesson also discusses the deductions from gross total income. The deductions are available only to the assessee where the gross total income is positive. If however, the gross total income is nil or negative, the question of any deduction from the gross total income does not arise. For this purpose, the expression 'gross total income' means the total income of the assessee computed in accordance with the provisions of the Income-tax Act before making any deduction under Chapter VIA. The aggregate of income computed under each head, after giving effect to the provisions for clubbing of income and set off of losses, is known as "Gross Total Income". Sections 80A to 80U of the Income-tax Act lay down the provisions relating to the deductions allowable to assessee from their gross total income. The income arising after deduction under section 80C to 80U is called Total Income.

2.2 OBJECTIVES

At the end of this lesson, you will learn

- What are the provisions of set off/carry forward and set off of losses
- How losses can be set off inter-head and intra-head.
- The conditions to be satisfied for carry forward and set off of loss from house property, business loss and unabsorbed depreciation.
- Up to what period the loss can be carried forward and set-off.
- The type of deductions allowable from gross total income
- What are the permissible deductions in respect of payments
- What are the permissible deductions in respect of incomes
- What are the deductions allowable in the case of a person with disability.

2.3 SET-OFF AND CARRY FORWARD OF LOSSES

Income tax is levied on the total income of previous year of an assessee. Hence it is necessary to ascertain the total income by aggregating the income of different heads. An assessee may have both positive income and negative income (loss). The department of income tax have given relief to assesseees that if there is loss from one head of income it can be set off from other heads of income. But if a loss cannot be set off in the same assessment year it can be forward and set off in future against income of that year. Therefore the topic is divided into two headings namely: i) set-off of losses; and ii) carry forward and set off losses.

2.3.1 A. Set-off of Losses

A loss can be set-off primarily within the same head and if it still remains unadjusted it can be set off from other heads of income. It has been divided into following two types:

1. Set-off of loss from one source against income from another source within the same head of income. [Section 70].

The general rule is that loss from one source can be set-off from another source falling under the same head of income. For example, an assessee is running two businesses A and B. There is a profit of Rs 200,000 in business A whereas there is a loss of Rs. 100,000 in business B. The assessee can setoff loss from business B with the income of business A and his total income will be Rs 100,000. However there are six exceptions to the rule that a loss can be set-off against any other income under the same head.

- Loss from speculation business cannot be set off against income from other sources. This loss can be set off only against income from another speculation business.
- Loss of specified business under section 35AD cannot be set off against income from other business. This loss can be set off only against income from other specified business.
- Long term capital loss cannot be set off against short term capital gain. This loss can be set off only against long term capital gain.
- Loss from the activity of owning and maintaining race horses shall be set off against income from owning and maintaining race horses only and not against any other income under the head other sources.
- Loss in respect of casual income falling under section 56(2)(ib), viz, lottery, gambling, betting, winning from races (including horse races) cannot be set-off against any income falling under head other sources. In fact, such a loss can't be setoff at all.

□ Loss from an exempted source can't be set-off from a source of income which is taxable. For example, agriculture income can't be set-off from non-agriculture income.

2. Set-off of loss of one head against the income of another head in the same assessment year, i.e., inter-head set-off [Section 71]:

The general rule is that loss under one head of income can be adjusted against income under another head. However, there are certain exceptions to this rule as:

□ Where the net result of the computation under any head of income (other than 'Capital Gains') is a loss, the assessee can set-off such loss against his income assessable for that assessment year under any other head, including 'Capital Gains'.

□ Where the net result of the computation under the head "Profits and gains of business or profession" is a loss, such loss cannot be set off against income under the head "Salaries".

□ Where the net result of computation under the head 'Capital Gains' is a loss, such capital loss cannot be set-off against income under any other head.

□ Speculation loss and loss from the activity of owning and maintaining race horses cannot be set off against income under any other head.

2.3.2 B. Carry forward and set off of losses

If it is not possible to set off the losses during the same assessment year in which they occurred, so much of the loss as the assessee has not been able to set off out of the following losses can be carried forward for being set off against his income in the succeeding years provided the losses have been determined in pursuance of a return filed by the assessee within the time allowed u/s 139(i) and it is the same assessee who sustained the loss.

□ **Loss under the head income from house property:** Any loss under this head can be carried forward up to 8 assessment years immediately following the assessment year for which the loss was first computed and set off from the same head.

□ **Loss of non-speculation business or profession:** Any non-speculation business loss can be carried forward up to 8 assessment years immediately following the assessment year for which the loss was first computed and set off against any income falling under the business or profession.

□ **Loss of speculation business:** Any speculation business loss can be carried forward up to 4 assessment years immediately following the assessment year for which the loss was first computed and set off against the profit of any speculation business carried on by assessee.

□ **Loss of specified business:** No limit is prescribed by the Act which means it can be carried forward till it is set off. But loss can be set-off against from any specified business carried on by assessee.

□ **Short term capital loss or long term capital loss:** Any loss under this can be carried forward up to 8 assessment years immediately following the assessment year for which the loss was first computed. Mode of set-off: A brought forward long term capital loss can be set-off against long term capital gain while as brought forward short term capital loss can be set off against any capital gain.

□ **Loss from activity of owning and maintaining race horses:** such loss can be carried forward up to 4 assessment years and can be set off against income from owning and maintaining of horses.

Rules regarding unabsorbed depreciation:

With effect from AY 2003-04, unadjusted depreciation can be carried forward till it is fully adjusted from any income during the succeeding previous years. It shall be treated as depreciation of succeeding previous years. In case there is carry forward business loss as well as carry forward unabsorbed depreciation, then the following order should be followed for set off

- Firstly current depreciation secondly brought forward business loss and thirdly brought forward unabsorbed depreciation.

2.4 AGGREGATION OF INCOME

Clubbing of income means Income of other person included in assessee's total income, for example: Income of husband which is shown to be the income of his wife is clubbed in the income of Husband and is taxable in the hands of the husband. Under the Income Tax Act a person has to pay taxes on his income. A person cannot transfer his income or an asset which is his one of source of his income to some other person or in other words we can say that a person cannot divert his income to any other person and says that it is not his income. If he do so the income shown to be earned by any other person is included in the assessee's total income and the assessee has to pay tax on it. Inclusion of other's Incomes in the income of the assessee is called Clubbing of Income and the income which is so included is called Deemed Income. It is as per the provisions contained in Sections 60 to 64 of the Income Tax

Act. For example: A purchased a house property in the name of his wife B. A let out this house property. The rental income earned by A in name of his wife B is taxable in the hands of A.

While aggregating the income of an assessee, following are also included in the total income:

- (i) Income of other persons to be included in the income of individual (Section 60-645).
- (ii) Income received from firm assessed as firm and Association of Persons (Section 66 & 67).
- (iii) Deemed Incomes (Section 68-69).

2.4.1 Incomes of other persons to be included in the income of individual (Section 60-645).

Section 60-65 deal with such cases where a particular income is earned or received by another person and does not belong to the assessee but for Income-Tax purposes, such incomes are included in the total income of the assessee.

1. Transfer of income without transfer of Asset [Section 60]: If any person transfers income without transferring the ownership of the asset, such income will be taxable in the hands of the transferor. Ex. X owns 4000, 14% debentures of A Ltd. of Rs. 100 each, he transfers interest income to his friend Y without transferring the ownership of Debentures. In this case although interest will be received by Y but it is taxable in the hands of X.

2. Revocable transfer of Asset [Section 61]: If any person transfers any asset to any other person in such form and condition that such transfer is revocable at any time during the lifetime of the transferee, the income earned through such asset is chargeable to tax as the income of the transferor. For ex. X transfers a house property to A. However, X has right to revoke the transfer during the life time of A. It is a revocable transfer and income arising from the house property is taxable in the hands of X.

3. Remuneration to Spouse [Section 64(1)(ii)]: An individual is chargeable to tax in respect of any remuneration received by the spouse from a concern in which the individual has *substantial interest. This provision has an exception. If the remuneration is received by spouse by the application of technical or professional knowledge or experience clubbing provisions will not take place. For ex. X has substantial interest in A Ltd. and Mrs. X is employed by A Ltd. without any technical or professional qualification. In this case salary income of Mrs. X shall be taxable in the hands of X.

4. Income from assets transferred to spouse[Section 64(1)(iv)]: Where an asset is transferred by an individual to his spouse directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart, any income from such asset is deemed to be the income of the transferor. For ex. Mrs. A transfer's 100 debentures of IFCI to her husband without adequate consideration. Interest income on these debentures will be included in the income of Mrs. A.

5. Income from asset transferred to son's wife[Section 64(1)(vi)]: If an individual, directly or indirectly transfers asset, without adequate consideration to son's wife, income arising from such asset is included in the income of the transferor. For ex. Mrs. A transfer's 100 debentures of IFCI to her son's wife without adequate consideration. Interest income on these debentures will be included in the income of Mrs. A.

6. Income from asset transfer to a person for the benefit of spouse/ son's wife [Section 64(1)(vii)]: If an individual, directly or indirectly transfers asset, without adequate consideration to a person or an association of persons for the benefit of his/her spouse /son's wife, income arising from such asset directly or indirectly is included in the income of the transferor. For Ex. X transfers Government bonds without consideration to an association of persons, subject to the condition that the interest income from these bonds will be utilized for the benefit of Mrs. X or Mrs. X son's wife. Interest from bonds will be included in the income of X

7. Income of a minor child [Section 64(iA)]: All income which arises to the minor shall be clubbed in the income of his parents. Income will be included in the income of that parent whose total income is greater. This case has two exceptions.

(1) Income of minor child suffering from specified disability.

(2) Income of minor child on account of manual work or involving application of his skill/talent etc.

*Substantial Interest: An individual is deemed to have substantial interest if he beneficially holds equity shares carrying not less than 20% voting powering case of a company or is entitled to not less than 20% of the profits in case of a concern other than a company , at any time during the previous year.

Some special points to remember:

1. If an individual makes a gift in cash or by cheque to his spouse and that money is utilized by the spouse for purchase of an asset. The income earned by the spouse from that asset will not be clubbed in the income of the individual.
2. In order to invoke clubbing provisions there must be relation of husband and wife. That means if a person transfers asset to his would be spouse before marriage income arising from such asset will not be included in the income of transferor.
3. Negative income is also income. Under the Income Tax Act income does not means positive income only. The term income includes negative income or loss also.
4. Income from accretion to asset is not taxable in the hands of the transferor.
5. Income from saving out of pin money is not included in the income of husband.
6. Income of minor child is clubbed with the income of the parent whose income after excluding the share of minor's income is greater.
7. If trust is created for the benefit of minor child and income during minority of child is being accumulated and added to corpus of trust and income from increased corpus is given to the child after attaining majority, clubbing provisions are not applicable.

2.4.2 Income received from AOP[Section 67A]

In the aggregation process of total income of the assessee following income is included in the total income of the assessee but this income is tax free(Section 67A). It is:

If the assessee is a member of an association of persons or body of individuals other than Hindu Undivided Family, any portion of the amount which he is entitled to rebate on the income received from the association or body on which income-tax has already been paid by the association or body.

2.4.3 Deemed Incomes[Section 68-69]

In certain cases, some amounts are deemed as income in the hands of the assessee though they are actually not in the nature of income. These cases are contained in sections 68, 69, 69A, 69B, 69C and 69D. The Assessing Officer may require the assessee to furnish explanation in such cases. If the assessee does not offer any explanation or the explanation offered by the assessee is not satisfactory, the amounts

referred to in these sections would be deemed to be the income of the assessee. Such amounts have to be aggregated with the assessee's income.

Cash credits (sec 68)

Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.

Unexplained investments (sec 69)

Where in the financial year immediately preceding the assessment year the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year.

Unexplained money, etc (Sec 69A)

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, bullion, jewellery or valuable article is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.

Amount of investments, etc., not fully disclosed in books of account(69B.)

Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article, and the Assessing Officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by

him is not, in the opinion of the Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial

Unexplained expenditure, etc (69C).

Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not, in the opinion of the Assessing Officer, satisfactory, the amount covered by such expenditure or part thereof, as the case may be, may be deemed to be the income of the assessee for such financial year:

Provided that, notwithstanding anything contained in any other provision of this Act, such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as a deduction under any head of income.

Amount borrowed or repaid on hundi (69D)

Where any amount is borrowed on a hundi from, or any amount due thereon is repaid to, any person otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid for the previous year in which the amount was borrowed or repaid, as the case may be:

Provided that, if in any case any amount borrowed on a hundi has been deemed under the provisions of this section to be the income of any person, such person shall not be liable to be assessed again in respect of such amount under the provisions of this section on repayment of such amount. For the purposes of this section, the amount repaid shall include the amount of interest paid on the amount borrowed.

2.5 DEDUCTIONS TO BE MADE FROM GROSS TOTAL INCOME

The deduction from gross total income is available only where the gross total income is positive. If however income is negative, the question of any deduction does not arise. Section 80A to 80 U of the Income-tax Act lays down the provisions relating to the deductions available to assesseees from their gross total income.

Deductions are available in two categories:

- a. Deduction in respect of certain payments (section 80C to 80GGC).

b. Deduction in respect of certain incomes (section 80IA to 80U).

2.5.1 A. Deduction in respect of certain payments

A1. Deduction regarding approved savings in P.F., LIC Premium etc (80C)

Eligible assesses: Individual and HUF

Entitlement: Deduction from the Gross Total Income of an amount equal to the investments made, subject to a maximum amount of Rs. 150,000.

Nature of Investments:

- a. Life Insurance policy taken on the life of an individual assessee or spouse and any child of such individual, and any member of the Hindu Undivided Family.
- b. Amounts paid to effect or to keep in force a contract for a non-cumulative deferred annuity not being an annuity plan.
- c. Deduction from the salary payable by or on behalf of the Government to any individual, in accordance with the conditions of his service, for securing to him a deferred annuity or making provision for his wife or children, to the extent of one-fifth of salary.
- d. Any contribution made by an individual only to any provident fund to which the Provident Funds Act, 1925, applies; a Recognised provident fund; an approved superannuation fund.
- e. Subscription to the notified securities of the Central Government.
- f. Any contribution to a PPF by individual or HUF.
- g. Subscription to other notified savings certificates defined in Section 2(c) of the Government Savings Certificates Act, 1959.
- h. Contributions made by an individual or HUF, for participation in the Unit-Linked Insurance Plan, 1971.
- i. Any contribution to effect or keep in force any notified annuity plan of the LIC or any other insurer.
- j. Any subscription, to any units of any Mutual Fund or the Unit Trust of India under any notified plan formulated by the Central Government.

k. Subscription to the notified deposit scheme of or contribution to any such pension fund set up by the National Housing Bank established under Section 3 of the National Housing Bank Act, 1987.

l. Tuition fees (excluding any payment towards any development fees or donation or payment of similar nature), whether at the time of admission or thereafter, to any university, college, school or other educational institution situated within India;

m. For purchase or construction of a residential house property, the income of which is chargeable to tax under the head “Income from House Property”, where such payments are made towards or by way of:

a. Any instalment or part payment of the amount due under any self- financing or other scheme of any development authority, housing board or other authority engaged in the construction and sale of house property on ownership basis; or

b. Any instalment or part payment of the amount due to any company or cooperative society of which the assessee is a shareholder or member towards the cost of the house property allotted to him; or

c. Re-payment of the amount borrowed by the assessee from:

(1) The Central Government or any State Government; or

(2) Any bank, including a co-operative bank, or

(3) The Life Insurance Corporation, or

(4) The National Housing Bank, or

(5) Any public company formed and registered repayment of principal part only not interest in India with the main object of carrying on the business of providing long-term finance for the construction or purchase of houses in India for residential purposes, eligible for deduction under Section 36(1)(viii), or

(6) Any company in which the public are substantially interested or any co-operative society, where such company or co-operative society is engaged in the business of financing the construction of houses; or

(7) The assessee's employer where such employer is a public company or a public sector company or a university established by law or a college affiliated to such university or a local authority or a cooperative society;

(8) The assessee's employer where such employer is an authority or a board or a corporation or any other body established under a Central or State Act (w.e.f. A.Y. 2006-07).

d. Stamp duty, registration fee and other expenses for the purpose of transfer of such house property to the assessee.

n. Subscription to equity shares or debentures or units forming part of any eligible issue of capital.

o. Fixed deposits for a minimum period of 5 years in any Scheduled Banks (w.e.f. A.Y. 2007-08).

p. As subscription to such bonds issued by the National Bank for Agriculture and Rural Development, as the Central Government may, by notification in the Official Gazette specify in this behalf.

q. In an account under the Senior Citizens Savings Scheme Rules, 2004.

r. As five year time deposit in an account under the Post Office Time Deposit Rules, 1981.

A-2. Deduction in respect of contribution to certain pension funds persons (80CCC)

Covered- individual.

Eligible Amount- Deposit or payment made to LIC or any other insurer in the approved annuity plan for receiving pension.

Extent of Deduction- Least of amount paid or Rs. 1,50,000/- .

A-3. Deduction in Respect of Contribution to Pension Scheme of Central Govt., or of any other Employer (80CCD).

Covered - Individual.

Eligible Amount: the amount of deduction shall be as follows

1. For employees (Govt., or Non-Govt.): Employees own contribution or 10% of salary whichever is less and contribution of central govt. / other employer or 10% of salary whichever is less.

2. For other employees (self-employed): depositors own contribution or 10% of gross total income, whichever is less.

The maximum amount of deduction u/s CCD is Rs 1,50,000 only.

A-4. deduction in respect of investment made under any notified saving scheme (80CCG)

Deduction is allowed if the following conditions are satisfied:

1. The assessee is a resident individual.
2. His gross total income does not exceed 12 Lakh.
3. He has acquired listed shares or listed units of an equity oriented funds in accordance with a notified scheme
4. The investment is locked in for a period of 3 years from the date of acquisition in accordance with the above scheme.
5. The assessee satisfies any other condition as may be prescribed.

If the above conditions are satisfied, a deduction will be allowed under section 80CCG. The amount of deduction is 50% of the amount invested in equity shares. However, the amount of deduction under this section cannot be more than ` 25,000. The deduction shall be allowed for 3 consecutive assessment years beginning with assessment years in which listed equity shares or units were first acquired.

A-5. Deductions in Respect of Medical Insurance Premia (80D)

Deduction regarding health insurance is allowed to individuals and HUFs. Where the assessee is an individual, the sum referred to in sub-section (1) shall be the aggregate of the following:

(a) the whole of the amount paid to effect or to keep in force an insurance on the health of the assessee or his family or “any contribution made to the Central Government Health Scheme” or such other scheme as may be notified by the Central Government in this behalf or any payment made on account of preventive health check-up of the assessee or his family and the sum does not exceed in the aggregate Rs 25000 (Rs 30000 in case of senior citizens); and

(b) the whole of the amount paid to effect or to keep in force an insurance on the health of the parent or parents of the assessee or any payment made on account of preventive health check-up of the assessee or

his family as does not exceed in the aggregate RsRs 25000 (Rs 30000 in case of senior citizens). The deduction in respect of payment made on account of preventive health check up shall not exceed Rs 5,000.

Where the assessee is a Hindu undivided family, the sum referred to in sub-section (1) shall be the whole of the amount paid to effect or to keep in force an insurance on the health of any member of that Hindu undivided family as does not exceed in the aggregate Rs 25000 (Rs 30000 in case of senior citizens).

A-6. Deductions in respect of maintenance including medical treatment of a dependent who is a person with disability (80DD)

Persons Covered- Resident Individual/HUF.

Eligible Amount-

(a) Expenditure incurred on medical treatment [including nursing], training and rehabilitation of a disabled dependent, or

(b) Any payment or deposit made under a scheme framed by LIC or any other insurer or the administrator or the specified company and approved by the Board for payment of lump sum amount or annuity for the benefit of dependent with disability.

Extent of Deduction: (a) Rs. 75,000/- in case of normal disability or (b) Rs. 125,000/- in case of severe disability.

A-7. Deduction in respect of medical treatment, etc. (80DDB)

An individual (*less than 60 years of age*) can claim up to Rs 40,000 for the treatment of specified critical ailments. This can also be claimed on behalf of the dependents. The tax deduction limit under this section for Senior Citizens is Rs 60,000 and for very Senior Citizens (*above 80 years*) the limit is Rs 80,000.

To claim Tax deductions under Section 80DDB, it is mandatory for an individual to obtain 'Doctor Certificate' or 'Prescription' from a specialist working in a Govt. or Private hospital.

For the purposes of section 80DDB, the following shall be the eligible diseases or ailments:

- Neurological Diseases where the disability level has been certified to be of 40% and above;

- (a) Dementia
- (b) Dystonia Musculorum Deformans
- (c) Motor Neuron Disease
- (d) Ataxia
- (e) Chorea
- (f) Hemiballismus
- (g) Aphasia
- (h) Parkinson's Disease

- Malignant Cancers
- Full Blown Acquired Immuno-Deficiency Syndrome (AIDS) ;
- Chronic Renal failure
- Hematological disorders
 - Hemophilia
 - Thalassaemia

A-8. Deduction in respect of interest on loan taken for education (80E).

Persons Covered- Individual.

Extent of Deduction- Entire amount of interest.

Eligible Amount- Any amount paid by way of interest on loan taken from any financial institution or any approved charitable institution for his/her higher education or w.e.f. 14-2008 for the purpose of higher education of his/her spouse, children and legal guardian of the Individual. Relevant Conditions/Points:

1. Amount should be paid out of income chargeable to tax.
2. All field of studies including vocational studies pursued after passing the senior secondary examination or its equivalent from any school, board or university recognized by the central govt. or

state govt. or local authority or by any other authority authorised by the central govt. or state govt. or local authority to do so.

3. Approved charitable institution means an institution established for charitable purposes and notified by the Central Government u/s. 10(23C) or referred in 80G(2)(a).

4. Financial institution means banking company or financial institution notified by Central Government.

5. The deduction is allowed in the initial assessment year (i.e., the assessment year relevant to the previous year, in which the assessee starts paying the interest on loan) and 7 assessment years. Immediately succeeding the initial assessment year or until the interest is paid in full whichever is earlier.

A-9 Deduction In Respect of Donations to Certain Funds, Charitable Institutions, Etc. (80G)

Persons Covered-All assesseees [except for 80G (2)(c), which is applicable for donations made only by company] to the Indian Olympic Association or to any other Association or Institution for the development of infrastructure for sports & games or the sponsorship of sports & games, in India.

Eligible Amount- Any sums paid in the previous year as Donations to certain funds, charitable institutions etc. specified u/s. 80G (2).

Relevant Conditions/Points

1. Donation in kind is not eligible for deduction.
2. Donations paid out of another year's income or out of income not includible in the assessment of current year are also eligible for deduction. Lt. F. No. 45/313/66 – ITJ (61) dt. 2-12-1966.

Extent of Deduction

Without any ceiling of 10% of adjusted Gross Total Income:—

(a) 100% of donation if donation given to

(i) National Defence Fund set up by the Central Government;

- (ii) Prime Minister's National Relief Fund;
- (iii) Prime Minister's Armenia Earthquake Relief Fund;
- (iv) Africa (Public Contributions — India) Fund;
- (v) National Foundation for Communal Harmony;
- (vii) An approved university/educational institution of National eminence;
- (viii) The Maharashtra Chief Minister's Relief Fund
- (ix) Chief Minister's Earthquake Relief Fund, Maharashtra;
- (x) Any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of earthquake in Gujarat;
- (xi) Any Zila Saksharta Samiti constituted in any district under the chairmanship of the Collector of that district;
- (xii) National Blood Transfusion Council or to any State Blood Transfusion Council;
- (xiii) Any fund set up by a State Government for the medical relief to the poor;
- (xiv) The Army Central Welfare Fund or the Indian Naval Benevolent Fund or the Air Force Central Welfare Fund,
- (xv) Andhra Pradesh Chief Minister's Cyclone Relief Fund, 1996;
- (xvi) National Illness Assistance Fund;
- (xvii) Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund in respect of any State or Union Territory;
- (xviii) National Sports Fund;

(xix) National Cultural Fund;

(xx) Fund for Technology Development and Application;

(xxi) National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities;

(xxii) Any trust, institution or fund to which Section 80G(5C) applies for providing relief to the victims of earthquake in Gujarat (contribution made during January 26, 2001 and September 30, 2001) **or**

(b) 50% of donation if donation given to:

Jawaharlal Nehru Memorial Fund; Prime Minister's Drought Relief Fund; National Children's Fund (deduction shall be allowed 100% w.e.f. A.Y 2014- 15); Indira Gandhi Memorial Trust; Rajiv Gandhi Foundation.

With ceiling of 10% of adjusted Gross Total Income:—

Where the aggregate of sums exceed 10% of adjusted gross total income, then such excess amount is ignored for computing such aggregate.

(a) 100% of qualifying amount, if donation given to Government or any approved local authority, institution or association to be utilised for the purpose of promoting family planning; Donation by a Company to the Indian Olympic Association or to any other notified association or institution established in India for the development of infrastructure for sports and games in India or the sponsorship of sports and games in India.

(b) 50% of qualifying amount if donation given to any other fund or any institution which satisfies conditions mentioned in Section 80G(5); Government or any local authority to be utilised for any charitable purpose other than the purpose of promoting family planning, Any authority constituted in India for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns, villages or both; Any corporation referred in Section 10(26BB) for promoting interest of minority community; For repairs or renovation of any notified temple, mosque, gurudwara, church or other place.

A-10. Deduction in respect of expenditure incurred on payment of house rent (80GG):

Persons Covered- Individual.

Deductions admissible under this Section is:

- i. Statutory limit Rs 5000;
- ii. Actual rent paid less 10% of 'Adjusted Total Income'.
- iii. 25% of such 'Adjusted Total Income'. Whichever is less. Adjusted GTI = GTI - (LTCG + STCG on shares covered under STT + income referred to in section 115A + all other deductions u/s 80 except 80GG).

A-11. Deduction in respect of contribution given by companies to political parties or electoral trust (80GGB)

Any sum contributed by an Indian Company, other than cash, in the previous year to any political party or to an electoral trust shall be allowed as deduction while computing its total income.

A-12. Deduction in respect of contribution given by any person to political parties or electoral trust (80GGC)

Any sum contributed by an assessee, other than cash, in the previous year to any political party or to an electoral trust except local authority and every artificial juridical person wholly or partly funded by the government shall be allowed as deduction while computing its total income.

2.5.2 B. Deduction in respect of certain incomes

B-1. Deduction in respect of profits and gains from industrial undertakings or enterprise engaged in infrastructure development (section 80-IA).

Where gross total income of assessee includes any profits and gains derived by an undertaking or an enterprise from any eligible business, a deduction shall be allowed to stated percentage of profit and gains from such business for stated number of years.

1. Undertaking engaged in providing infrastructure facility (80IA(4)(i))

Eligible business: developing, operating and maintaining or developing operating and maintaining infrastructure facility.

Form of organisation: industrial undertaking owned by a company registered in India or by a consortium of such companies.

Rate of deduction: @100% of profits of such eligible business.

Commencement of operation: on or after 1-4-1995

Period of deduction: 10 years out of 20 years (out of 15 years in case of ports airport etc)beginning with the year in which undertakings develops such infrastructural facility.

2. Telecommunication services (80IA(4)(ii))

Eligible business: telecommunication services, radio paging, domestic satellite services, network of trunking, broadband network and internet services.

Form of organisation: all enterprises whether corporate or not.

Commencement of operation: on or after 1-4-1995 but on or before31-3-2005.

Rate of deduction: 100% of profits and gains from such business for first 5 consecutive AY's out of first 15 years.

3. Industrial Park (80IA(4)(iii))

4. Power Sector (80IA(4)(iv))

Eligible business: generation of power; or generation and distribution of power; or transmission or distribution by laying a network of new transmission; or undertakingsubstantial renovation and modernisation of the existing transmission or distribution lines.

Form of organisation: all enterprises whether corporate or not. Commencement of operation: after 1-4-1993 to 31-3-20017.

Rate of deduction: 100% of profits and gains from such business for any 10 consecutive AY's out of first 15 years beginning from the year in which undertaking starts operation.

5. Undertaking setup for reconstruction or revival of power generating plant (80IA(4)(v))

Eligible business: reconstruction or revival of power generating plant.

Form of organisation: Indian Co.

Commencement of operation: before 31-3-20017. Rate of deduction: 100% of profits and gains from such business for any 10 consecutive AY's out of first 15 years beginning from the year in which undertaking starts operation.

B-2. Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings (section 80-IB).

The deduction under section 80-IB is available to an assessee whose gross total income includes profits and gains derived from the following business. **for details refer to bare Act.

B-3. Special provision in respect of certain undertakings or enterprises in certain special category states (section 80-IC). **for details refer to bare Act.

B-4. Deduction in respect of employment of new workmen (80JJAA).

Eligible assessee: Indian co.

GTI should include should include profits and gains derived from manufacture of goods in factory.

Amount of deduction: 30% of additional wages paid to new regular workmen employed by the assessee in the previous year for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

Additional wages means the wages paid to new regular workman in excess of 100 workmen employed during the previous year.

However in case of an existing factory additional wages shall be nil if the increase in the number of regular workmen employed during the year is less than 10% of the existing number of workmen employed in such factory as on the last day of the preceding year.

B-5. Deduction in respect of royalty income etc., of authors of certain books other than text books (80QQB).

Amount of deduction: the gross total income of assessee pertaining to the previous year includes royalty or the copyright fees, there shall, in accordance with and subject to the provisions of this section, be allowed a deduction of 100% of such income or Rs. 300,000, whichever is less.

B-6. Deduction in respect of royalty on patents (80RRB):

(1) Where in the case of an assessee, being an individual, who is –

(a) Resident in India;

(b) A patentee;

(c) In receipt of any income by way of royalty in respect of a patent registered on or after the 1st day of April, 2003 under the Patents Act, 1970, and his gross total income of the previous year includes royalty, there shall, in accordance with and subject to the provisions of this section, be allowed a deduction of 100% of such income or Rs 300,000, whichever is less.

B-7. Deduction in respect of interest on deposits in savings account (80TTA):

Eligible assessee: individual or HUF.

Eligible income: interest on deposits in saving accounts with:

a) A banking company to which the Banking Regulation Act, 1949 (10 of 1949), applies (including any bank or banking institution referred to in section 51 of that Act);

(b) A co-operative society engaged in carrying on the business of banking (including a cooperative land mortgage bank or a co-operative land development bank); or

(c) A Post Office as defined in clause (k) of section 2 of the Indian Post Office Act, 1898.

Amount of deduction: actual interest or Rs 10,000 whichever is less.

B-8. Deduction in case of a person with disability (80U):

Amount of deduction: In computing the total income of an individual, being a resident, who, at any time during the previous year, is certified by the medical authority to be a person with disability, there shall be allowed a deduction of a sum of Rs 50,000; or a person with severe disability shall be allowed a deduction of a sum of Rs 1,00,000.

2.6 SUMMARY

Income tax is levied on the total income of previous year of an assessee. Hence it is necessary to ascertain the total income by aggregating the income of different heads. An assessee may have both positive income and negative income (loss). The department of income tax have given relief to assesseees that if there is loss from one head of income it can be set off from other heads of income. But if a loss cannot be set off in the same assessment year it can be forward and set off in future against income of that year.

Set-Off of Losses from one source against Income from another source under the same Head of Income [Section 70]: If the net result for any assessment year in respect of any source falling under any head of income is a loss, the assessee is entitled to set off the amount of such loss against his income from any other source under the same head. However, Loss from Speculation Business, Loss from the activity of owning and maintaining race horses, long-term capital loss can be set-off from any other source of income.

Where any individual transfers directly or indirectly any asset (other than a house property) to the spouse, the income from such asset shall be included in the income of the transferor

Carry-Forward and Set-Off of Losses If it is not possible to set-off the losses during the same assessment year in which these occurred, so much of the loss as has not been so set-off out of the

following losses, can be carried forward to the following assessment year and so on to be set-off against the income of those years provided the losses have been determined in pursuance of a return filed by the assessee and it is the same assessee who sustained the loss.

However, losses suffered under the following heads are not allowed to be carried forward and set off:

(1) Losses under the head 'salaries'.

(2) Losses under the head 'Income from other sources' (excepting loss suffered from the activity of owning and maintaining race horses).

– W.e.f. assessment year 2000-2001, Section 72A has been substituted by new section to provide for carry forward and set off of accumulated loss and unabsorbed depreciation allowance in case of:

(i) Amalgamation [Section 72A(1), (2) and (3)], or

(ii) Demerger [Section 72A(4) and (5)], or

(iii) Reorganisation of business [Section 72A(6)].

Submission of Return for Loss (Section 80): An assessee is not entitled to carry-forward a loss unless he has filed a return of loss to the Department in time and in the prescribed form. It is obligatory on the part of the assessee to file such return; otherwise he will be deprived of the benefit of carryforward of losses. In fact, only that amount of loss is allowed to be carried-forward which has been computed by the Assessing Officer and not by the assessee.

Similarly aggregation of Income was discussed. The aggregate of income computed under each head, after giving effect to the provisions for clubbing of income and set off of losses, is known as "Gross Total Income". Clubbing of income means Income of other person included in assessee's total income, for example: Income of husband which is shown to be the income of his wife is clubbed in the income of Husband and is taxable in the hands of the husband. Under the Income Tax Act a person has to pay taxes on his income. A person cannot transfer his income or an asset which is his one of source of his income to some other person or in other words we can say that a person cannot divert his income to any other person and says that it is not his income. If he do so the income shown to be earned by any other person is included in the assessee's total income and the assessee has to pay tax on it. Inclusion of other's Incomes in the income of the assessee is called Clubbing of Income and the income which is so included is called Deemed Income. It is as per the provisions contained in Sections 60 to 64 of the

Income Tax Act. For example: A purchased a house property in the name of his wife B. A let out this house property. The rental income earned by A in name of his wife B is taxable in the hands of A.

Sections 80A to 80U of the Income-tax Act lay down the provisions relating to the deductions allowable to assessee from their gross total income. In order to further the Government Policy of attracting investment and activity in the desired direction and to provide stimulus to growth or to meet social objectives, concession in the form of 'deduction' from Taxable Income is allowed. Chapter VI-A of the Income-tax Act, 1961 contains such deduction provisions. With the advent of new philosophy of giving direct assistance to the desired goal and avoiding indirect route of tax concessions, the numbers of deductions are being omitted. This is also with a view to avoid complexity of tax law. In computing Total Income of an assessee deductions under sections 80CCC to 80U are permissible from "Gross Total Income". [Section 80A (1)]

Deduction not to be allowed unless return furnished [Sec. 80AC]

Where in computing the Total Income of an assessee of the Previous Year relevant to the Assessment Year commencing on the 1st day of April, 2006 or any subsequent Assessment Year, any deduction is admissible under Section 80-IA or Section 80-IAB or Section 80-IB or Section 80-IC or Section 80-ID or Section 80-IE, no such deduction shall be allowed to him unless he furnishes a return of his income for such Assessment Year on or before the due date specified under sub-section (1) of section 139.

"Gross Total Income" means the aggregate of income computed under each head as per provisions of the

Act, after giving effect to the provisions for clubbing of incomes (Sections 60 to 64) and set off of losses and but before making any deductions under this chapter. [Section 80B(5)].

The deductions under Chapter VIA are not available from the following incomes though these are included in the "Gross Total Income":

- (i) Long Term Capital Gains;
- (ii) Winnings from lotteries, cross word puzzles etc.
- (iii) Incomes referred to in Sections 115A to AD, 115BBA and 115D.

The aggregate amount of deductions under Chapter VIA [Sections 80CCC to 80U] shall not exceed the

“Gross Total Income” of the assessee. [Section 80A (2)]

PRACTICAL PROBLEMS

ILLUSTRATION I

Mr. Singh a resident of India, submits the following particulars of his income for the assessment year 2021-22.

| | Rupees |
|---|--------|
| I. Income from house let out(computed) | 9,500 |
| II. Profit from radio business | 19,600 |
| III. Profit from electric business | 1,800 |
| IV. Speculation income | 19,000 |
| V. Short-term capital gain | 32,000 |
| VI. Long –term capital gain (jewelry) | 9,250 |
| Current year’s depreciation amounted to | 2,500 |

The following items have been brought forward from preceding assessment year:

| | |
|---|-------|
| I. Loss from cycle businesses discontinued(2019-20) | 3,900 |
| II. Loss from electric business | 2,700 |
| III. Loss from radio business | 1,900 |
| IV. Unabsorbed depreciation of electric bussiness | 1,000 |
| V. Unabsorbed family planning expenditure | 2,600 |
| VI. Speculation loss | 3,200 |
| VII. STCL from the year 2017-18 | 4,100 |
| VIII. LTCL from the year 2018-19 | 6,450 |

You are required to compute his gross total income and deal with the carry forward of losses.

SOLUTION:

Computation of total Income of Mr. Singh

| | Rupees | RupeesRupees |
|--|---------------|---------------------|
| House Property | | |
| I. Income from let out house (computed) | | 9,500 |
| Business Income | | |
| i. Profit from radio business | 19,600 | |
| ii. Share of profit from electric business | <u>1,800</u> | |
| | 21,400 | |
| Less:Current year’s depreciation | <u>2,500</u> | |
| 18,900 | | |
| Set off B/F loss from cycle business | 3,900 | |
| | Rupees | RupeesRupees |
| Set off B/F loss from radio business | 1,900 | |

| | | | |
|---|-------------------|--------------|----------------------|
| Set off B/F loss from electric business | <u>2,7008,500</u> | | |
| | | 10,400 | |
| Set off B/F unabsorbed depreciation | | <u>1,000</u> | |
| 9,400 | | | |
| iii.Speculation Business income | 1,900 | | |
| Set off B/F loss from speculation business | <u>-3,200</u> | | |
| This loss shall be C/F to be set off against speculation income of future | <u>-1,300 Nil</u> | | |
| | | | 9,400 |
| Capital Gains | | | |
| STCG | 3,200 | | |
| Set off STCL of 2012-13 | <u>4,100</u> | -900 | |
| LTCG | 9,250 | | |
| Set off LTCL loss B/F | <u>6,450+2800</u> | | |
| Taxable Capital gain | | | 1,900 |
| Total income | | | <u>20,800</u> |

Note:

1. Loss from speculation business is not allowed to be set off out of the profits of a non – speculation business.
2. Unabsorbed expenditure on family planning is not allowed to be deducted in case of non-company assesses.
3. Loss of a discontinued business can set off out of profits of a continuing business.

ILLUSTRATION II

Mr. M Rafiq submits the following information of his incomes and losses for the year ending 31-3-2021. Compute his total income :

Rs

| | |
|---------------------------------|--------|
| 1. Salary income (computed) | 24,000 |
| 2. Income from house property : | |
| House A (income) | 10,000 |
| House B (loss) | 40,000 |
| House C (self-occupied) | 28,000 |
| 3.Income from business: | |
| Cloth business (profit) | 10,000 |
| Hardware business (loss) | 12,000 |
| Speculation (profit) | 12,000 |
| Speculation (loss) | 17,000 |

4. Capital gains:

| | |
|-------------------|--------|
| Short-term (gain) | 8,000 |
| Short-term (loss) | 24,000 |
| Long-term (gain) | 8,000 |

5. Other Sources:

| | |
|----------------------------------|--------|
| Income from betting | 12,000 |
| Income from card games | 9,000 |
| Interest from securities (gross) | 8,000 |

SOLUTION

Computation of total income of Mr. Rafiq

| | Rupees | Rupees | Rupees |
|--|----------------|----------------|----------------|
| Salaries | | | |
| Salary income (computed) | | | 24,000 |
| House property | | | |
| House A | | +10,000 | |
| House B | | -40,000 | |
| House C | | <u>-28,000</u> | |
| House property loss to be set off from other heads | | | -58,000 |
| Profits & Gains: | | | |
| | Rupees | Rupees | Rupees |
| Cloth business | +10,000 | | |
| Set off Hardware business loss | <u>-12,000</u> | -2,000 | |
| Speculation (profit) | +12,000 | | |
| Set off speculation loss | <u>-17,000</u> | | |
| Speculation loss to be C/F | <u>- 5,000</u> | Nil | |
| Business loss to be set off from other heads | | | -2,000 |
| Capital Gains: | | | |
| STCG | +8,000 | | |
| Set off STCL | <u>-24,000</u> | | |
| | -16,000 | | |

| | | |
|-------------------------------------|---------------|----------------------|
| LTCG | +8,000 | |
| STCL to be C/F | <u>-8,000</u> | Nil |
| Other sources: | | |
| Income from betting | 12,000 | |
| Income from cards | <u>9,000</u> | 21,000 |
| Interest on securities | | <u>8,000</u> |
| <u>Total income (Casual income)</u> | | <u>21,000</u> |

Note:

1. Business loss shall be set off from income from interest on securities.
2. House property loss of 58,000 shall be set off from salary income of 24,000 and balance from interest on securities 6,000. Unadjusted house property loss 28,000 shall be C/F.
3. No loss can be set off from casual incomes.

ILLUSTRATION III

The assessment of M & Bros. for the assessment years 2020-21 and 2021-22 shows the following results:

| | Ass. Year 2020-21 | Ass. Year 2021-22 |
|--|-------------------|-------------------|
| I Interest on securities | -2,000 | +2,000 |
| Ii Income from house property | +8,000 | +8,000 |
| PGBP: | | |
| a. Dealing in fruits | -30,000 | -12,000 |
| b. Manufacturing glass: | | |
| Profit before depreciation | +50,000 | +1,40,000 |
| Depreciation | +80,000 | +75,000 |
| c. Speculative transactions | +6,000 | -9,000 |
| Iv Income from other sources (bank interest) | +2,000 | +5,000 |
| V Short term capital gain | Nil | -25,000 |

Compute net assessable results for each of the two years giving full reasons for your working.

SOLUTION

Calculation of total income of M& Bros. for assessment year 2020-21

| | Rupees | Rupees |
|-----------------------------------|---------------|--------|
| Income from house property | +8,000 | |

Profits & gains:

| | | | |
|-----------------------------------|----------------|---------------|----------------|
| a. Dealing in fruits | | -30,000 | |
| b. Glass Manufacturing | + 50,000 | | |
| <i>Less:</i> Current depreciation | <u>-80,000</u> | | |
| Unabsorbed depreciation | <u>-30,000</u> | Nil | |
| c. Speculation profit | | <u>+6,000</u> | |
| Net loss from business | | | -24,000 |

Income from other sources:

| | | | |
|------------------------|---------------|---------------|---------------|
| a. Bank interest | | +2,000 | |
| Interest on securities | Rupees | Rupees | Rupees |
| | | <u>-2,000</u> | <u>Nil</u> |
| Gross total income | | | <u>Nil</u> |

Note: Losses to be C/F

| | |
|----------------------------|--------|
| a. Unabsorbed Depreciation | 30,000 |
| b. Business loss to be C/F | 16,000 |

(After adjusting 8,000 from HP income)

Calculation of total Income of M & bros. for assessment year 2021-22:**Income from house property** **+18,000****Profits & Gains:**

| | | | |
|-----------------------------------|---------------|----------------|---------------|
| a. Dealing in fruits | | -12,000 | |
| b. Glass Manufacturing | +1,40,000 | | |
| <i>Less:</i> Current Depreciation | <u>75,000</u> | | |
| Business profit | | <u>+65,000</u> | |
| Balance business income | | 53,000 | |
| B/F business loss | | <u>-16,000</u> | |
| | | 37,000 | |
| Unabsorbed <u>depreciation</u> | | <u>-30,000</u> | +7,000 |
| c. Speculation loss to be C/F | | <u>9,000</u> | |

Income from other sources:

| | |
|---------------------------|---------------|
| a. Bank interest | +5,000 |
| b. Interest on securities | <u>+2,000</u> |

+7,000

Total income 22,000

Notes:

1. Capital loss of 25,000 to be C/F as it cannot be set off from any other income.
2. Speculation loss to be C/F 9,000.

AGGREGATION OF INCOME

ILLUSTRATION I

Mr. X gifted gold jewelry worth Rs. 100000 to his wife Mrs. X on 1-1-2003. It was acquired on same day. On 1-5-2003 Mrs. X sold this jewelry for Rs 125000 and invested the same in a plot for Rs 240000. The remaining amount was paid by her out of her own funds. The plot was sold for Rs 1200000 on 1-11-2020. Compute the income chargeable to tax in the hands of Mr. X and Mrs. X on the sale of jewelry as well as plot if C.I.I for 2001-02 is 100, for 2003-04 is 109 and for 2020-21 is 301?

SOLUTION

| | Rs |
|--|-----------|
| Previous year 2003-04 | |
| Sale price of jewelry | 125000 |
| Less: Cost price | 100000 |
| S.T.C gain to be Mr. X's income | 25000 |
| Previous year 2020-21 | |
| Sale price of plot | 900000 |
| Less: Indexed cost [240000 x 301 / 109] | 662752 |
| L.T.C Gain | 237248 |
| Mr. X's income (in the ratio of amount invested) | |
| [237248 * 125000 / 240000] | 123567 |
| Mr. X's Income | 113681 |

ILLUSTRATION II

Mr. John's income computed under the head salaries is 269500. Last year he received arrears of salary and gifted 125000 out of these to his wife. Mrs. John invested on 1-1-2020 Rs 500000 in 15% debentures issued by a company.

These debentures were financed by Mrs. John as under:

- a) Rs 125000 received as gift from Mr. John
 b) Rs. 300000 out of her sitridhan.
 c) Rs. 75000 as loan taken from bank. Rate of interest is 18% p.a.
- On 1-1-2021 the company paid interest to Mrs. John .She invested this interest in a fixed deposit with a bank @12% p.a. interest for the period 1-1-2021 to 31-3-2021 was Rs. 2250.
- Compute the Gross Total Income of Mr. John and Mrs. John for the previous year 2015-16 explaining all the points clearly.

SOLUTION

A. Gross total Income of Mr. John

RsRs

Salaries

Computed Income

Other sources

Interest on debenture on the name of wife but u/s 64(1)(iii)

To be clubbed with Mr. John income)

[$500000 \times 15\% = 75000 \times 125000 / 500000$]

18750

G.T.I

288250

B. Gross Total Income of Mrs. John

Income from other sources

Interest on debenture($75000 \times 375000 / 500000$) 56250

Less: ded. For interest on losn taken from bank

[$75000 \times 18 / 100 \times 1 \text{ year}$]

13500

42750

Interest on Bank deposit

2250

G.T.I

45000

Note: In case the income of the gifted asset is reinvested, any further income from such reinvestment remains transferee's income.

2.7 GLOSSARY

- **Set-Off Losses:** When any loss relating to any particular previous year is set-off against the income of same previous year, it is called set-off of losses.
- **Carry forward of loss:** If any loss related to any previous year(or assessment year) cannot be set-off either under the same head or against the incomes of other heads during same previous year(or assessment year), such a loss can be carried forward to future previous years for setting off against incomes of future previous years(or assessment years).
- **Speculation Loss:** Any loss computed in respect of speculation business. Such a loss carried by an assessee shall not be set-off except against profits and gains,if any, of another speculation business.
- **Transfer of Income (section 60):** Where a person transfers to any other person income (whether revocable or not) from an asset without transferring that asset, the income shall be included in the total income of the transferor. “Transfer” includes any settlement, trust, covenant, agreement or arrangement.
- **Revocable transfer:** Where a person transfers any asset to any other person with a right to revoke the transfer, all income accruing to the transferee from the asset shall be included in the total income of the transferor.

- The income under revocable transfer of asset shall be included in the income of transferor even when only a part of income from transferred asset has been applied for the transferor.
- Irrevocable Transfer: In case of an irrevocable transfer of assets for a specified period, the income from such assets shall not be included in the income of transferor.
- Income to spouse from a concern in which such individual has substantial interest [Section 64(1)(ii)]: All such income as arises directly or indirectly, to the spouse of an individual by way of salary, commission, fees or any other remuneration, whether in cash or kind from a concern in which such individual has a substantial interest, shall be included in the income of the individual.
- Income to spouse from the assets transferred [Section 64(1)(iv)]: Where any individual transfers directly or indirectly any asset (other than a house property) to the spouse, the income from such asset shall be included in the income of the transferor.
- Income to Son's Wife [Section 64(1)(vi)]: Where any individual transfers, directly or indirectly, any asset to his/her son's wife without adequate consideration, after 1.6.1973, the income from such asset shall be included in the income of the transferor.
- Transfer for Immediate or Deferred Benefit of Son's Wife [Section 64(1)(viii)]: Any income arising, directly or indirectly, to any person or association of persons from assets transferred directly or indirectly after June 1, 1973, otherwise than for adequate consideration to the person or association of persons by such individual shall, to the extent to which the income from such assets is for the immediate or deferred benefit of his son's wife be included in computing the total income of such individual.
- Income to spouse through a third person [Section 64(1)(Vii)]: Where a person transfers some assets directly or indirectly to a person or association of persons (trustee or body of trustees or juristic person) without adequate consideration for the immediate or deferred benefit of his or her spouse, all such income as arises directly or indirectly from assets transferred shall be included in the income of the transferor.
- Clubbing of Income of Minor Child [Section 64(1a)]: All income which arises or accrues to the minor child (not being a minor child suffering from any disability of the nature specified in Section 80U) shall be clubbed in the income of his parent. However, any income which is derived by the minor from manual work or from any activity involving application of his skill, talent or specialised knowledge and experience will not be included in the income of his parent. In case the income of an individual includes any income of his minor child in terms of this

section [i.e. Section 64(1A)], such individual shall be entitled to exemption of the amount of such income or Rs. 1,500 whichever is less.

2.8 SELF ASSESSMENT QUESTIONS

1. What do you mean by “Set-off and carry forward of losses”? Which losses can be carried forward?

2. Discuss the provisions of the Income-tax Act relating to the set-off of losses.

3. Discuss the provisions of the Income-tax Act relating to carry-forward and set-off of losses, with particular reference to the provisions of Section 72A of the Act.

4. Explain in brief the deduction for the medical insurance premium paid by the assessee.

5. Enumerate the various rebates and reliefs available to individuals under the Income-tax Act, 1961.

6. What conditions are to be satisfied in order to claim a deduction for donations made to certain funds or/ and charitable institutions? Illustrate.

7. Explain the deduction given in respect of certain payments.

8. Explain the deduction given in respect of certain incomes.

9. Explain Deemed income. Elaborate the incomes that are treated as deemed incomes.

2.9 BOOKS RECOMMENDED

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. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; SahityaBhavan Publications.
4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.
5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.
6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.
7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

ASSESSMENT OF INDIVIDUALS AND H.U.F INCLUDING COMPUTATION OF TAX LIABILITY.

STRUCTURE:

3.1 Introduction

3.2 Objective

3.3 Assessment of Individuals

3.4 Tax treatment of income received from different institutions

3.5 Income of other persons to be included in the total income of an individual

3.6 Computation of Gross Total Income

3.7 Computation tax liability

3.8 Concept of H.U.F

3.9 Types of members

3.10 Joint Property of the family

3.11 Position under Hindu Succession Act, 1956

3.12 Computation of Income of the H.U.F.

3.13 Partition of a Hindu undivided family (Section 171)

- Who is entitled to share on partition
- Assessment after partition (Section 171)
- A partition of the HUF can be both total and partial

3.14 Summary

3.15 Glossary

3.16 Self-Assessment Questions

3.17 Books Recommended

3.1 INTRODUCTION

Income tax is that percentage of your income that you pay to the government to fund infrastructural development, pay the salaries of those employed by the state or central governments, etc. All taxes are levied based on the passing of a law, and the law that governs the provisions for our income tax is the Income Tax Act, 1961.

Income tax is only of the direct means of taxation like capital gains tax, securities transaction tax, etc., and there are many other indirect taxes that we pay like sales tax, VAT, Octroi, service tax, etc.

The income tax you pay every month or upon every contractual earning is what forms a large part of the revenue for the Government of India. These revenue functions are managed by the Ministry of Finance, which has delegated the responsibility to managing direct taxes (like income tax, wealth tax, etc.) to the Central Board of Direct Taxes (CBDT).

Income tax is applicable for individuals, businesses, corporate, and all other establishments that generate income. The Income Tax Act, 1961 regulates the collection, recovery, and administration of income tax in India. The government requires the tax amount for various purposes ranging from building the infrastructure to paying the state and central government's employees. It helps the government in generating a steady source of income that is used for the development of the nation.

The income tax is paid every month from the monthly earnings, however, it is calculated on an annual basis. The amount of income tax an individual has to pay depends on many factors.

Under the Department of Revenue of the Ministry of Finance, the Income Tax Department (IT Department) is responsible for monitoring the collection of Income Tax, Expenditure Tax, and various other Financial Acts that are passed every year in the Union Budget. The Central Board of Direct Taxes (CBDT) regulates the policy and planning of taxes. CBDT is also responsible for administering the direct tax laws through the IT Department. In addition to the collection of taxes, the IT department is also involved in prevention and detection of tax avoidance.

Income tax has to be paid by every individual person, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals (BOI), corporate firms, companies, local authorities and all other artificial juridical persons that generate income.

Taxes are calculated on the annual income of a person, and an annual cycle (year) in the eyes of the Income Tax law starts on the 1st of April and ends on the 31st of March of the next calendar year. The law recognizes and classifies the year as “Previous Year” and “Assessment Year”.

*The year in which income is earned is called the **previous year** and the year in which it is charged to tax is called the **assessment year**.*

*For example: Income earned between April 1st 2016 and March 31st 2017 is called the **income of the previous year** and will be charged to tax in the **next year, or the assessment year** that starts on April 1st 2017.*

Taxes are collected by the government in three primary ways:

1. Voluntary payment by taxpayers into designated banks, like advance tax and self-assessment tax.
2. Taxes Deducted at Source (TDS) which is deducted from your monthly salary, before you receive it.
3. Taxes Collected (TCS).

In this lesson the Income Tax Treatment with relation to Hindu Undivided Families (HUF) and individuals is being discussed. The tax implications, rates of tax and other issues relating to the above persons have been discussed elaborately. Hindu undivided family is treated as a separate taxable entity for the purpose of income tax assessment.

3.2 OBJECTIVES.

At the end of this lesson, you will learn

- What is a HUF, how it comes into existence
- When and how it can be partitioned and what are the tax implications before and after its partition.
- What is an individual.
- What are the rates applicable for taxing individual.
- How to calculate tax liability of Individual.

- What is Hindu Succession Act 1956.
- Computation of the income of H.U.F.
- Partition of a Hindu undivided family.

3.3 ASSESSMENT OF INDIVIDUALS

Individual includes both male and female assessee. The total income has to be computed as per the provisions of the Income-tax Act, 1961. In addition to individual's own income, income of other persons received by him in some other capacity or received by other persons is to be clubbed with individual's income. Following steps are considered for computing total income and to charge tax.

Step 1 – Determination of the residential status of the Assessee: First all we want to determine the residential status of the assessee. The residential status of a person has to be determined to find out which income is to be included in computing the total income. It decides whether the individual is to be taxed or not. The residential status of an individual is determined on the basis of the duration of time spent by him in India. . Based on the time spent by him, he may be (a) resident and ordinarily resident, (b) resident but not ordinarily resident, or (c) non-resident.

Step 2 – Classification of income under different heads: The Act specifies five heads of income. These heads of income consist of all possible types of income that can accrue to or be received by an individual. An individual is required to classify the income earned by him under the appropriate heads of income.

Step 3 – Exclusion of income not chargeable to tax: There are certain incomes which are wholly exempt from income-tax e.g. agricultural income. These incomes have to be excluded while calculating Gross Total Income. At the same time certain incomes are partially exempt from income tax e.g. House Rent Allowance, Education Allowance etc.. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed limits would enter computation of total income and have to be classified under the relevant head of income.

Step 4 – Computation of income under each head: Income is to be computed in accordance with the provisions governing a particular head of income. As per the rules certain deductions and allowances are allowed. These deductions are allowed while computing income under each head.

Step 5 – Clubbing of income of spouse, minor child etc.: In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive. That means if income increases the

tax amount to be paid also increases. We can see that some taxpayers who have the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been included in the Income-tax Act. As per the provisions of income tax act income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person when it is seen that the income is diverted for avoiding tax.

Step 6 – Set-off or carry forward and set-off of losses: An individual may have different sources of income under the same head of income. He might have profit from one source and loss from the other. As per the provision we can set off the losses under one head or form other heads or can carry forwards for the coming assessment years. All provisions related to that should be considered while computing total income of the Assessee.

Step 7 – Computation of Gross Total Income: The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

Step 8 – Deductions from Gross Total Income: There are deductions prescribed from gross total income. The allowable deductions in case of an individual are deductions under sections 80C, 80CCC, 80CCD, 80CCF, 80D, 80DD, 80DDB, 80E, 80G, 80GG, 80GGA, 80GGC, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, 80JJA, 80QQB, 80RRB, 80TTA and 80U. These deductions are allowed as per the rules prescribed in the income tax act.

Step 9 – Compute Total income: After allowing all deductions allowable, we can compute total income. **Step 10 – Application of the rates of tax on the total income:** Different slab of tax rates are available on basis of status and age of individual. . There also will be basic exemption limit.

3.4 TAX TREATMENT OF INCOME RECEIVED FROM DIFFERENT INSTITUTIONS:

1. As a member of HUF: Exempted u/s 10(2). But where an individual converts his individual property into common pool of HUF of which he is a member, income from such property shall be included in his individual income.

2. Income received as share from AOP. Share from AOP is treated as: If the individual income of all partners does not exceed the exempted first income slab, then share from such AOP is to fully added. However, if the individual income of any partner exceeds the first exempted income slab, then share from such AOP is not to be added in the income of the individual.
3. As a partner of firm assessed as firm u/s 184. Exempted But remuneration and interest on capital received is taxable under the head profits and gains to the extent it is allowed as deduction to the firm.
4. As a partner of firm assessed as firm u/s 185. Exempted But remuneration and interest on capital received from such firm is also exempted.
5. As a shareholder of a company. Exempted

3.5 INCOME OF OTHER PERSONS TO BE INCLUDED IN THE TOTAL INCOME OF AN INDIVIDUAL

The following incomes although accruing to other persons are included in the income of individual assessee:

1. Transfer of an income without transfer of asset.
2. Revocable transfer of asset.
3. Income of minor child.
4. Income from asset transferred to spouse, daughter in law by an individual without adequate consideration shall be included in the income of that individual.
5. Income from the asset transferred by an individual in such a way that benefit accrues directly to him.

3.6 COMPUTATION OF GROSS TOTAL INCOME

The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

Deductions from Gross Total Income:

There are deductions prescribed from gross total income. The allowable deductions in case of an individual are deductions under sections 80C, 80CCC, 80CCD, 80CCF, 80D, 80DD, 80DDB, 80E, 80G, 80GG, 80GGA, 80GGC, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, 80JJA, 80QQB, 80RRB, 80TTA and 80U. These deductions are allowed as per the rules prescribed in the income-tax act.

3.7 COMPUTATION OF TAX LIABILITY

After computing the total income, next step is to compute the tax liability. The following steps are to be followed:

1. Round of total income to the nearest multiple of 10.
2. Divide the total income into four parts:
 - i. LTCG - calculate tax @20%.
 - ii. STCG on shares which are subject to STT- calculate tax @15%.
 - iii. On casual income- calculate tax @30%.
 - iv. Balance is total income.

Calculate tax at following rate:

Application of the rates of tax on the total income:

The basic exemption limit is Rs 2, 50,000 for the assessment year 2021-22.

A) Normal Rates (individual whether male or female):

- Up to Rs: 2,50,000: Nil
- Rs: 2, 50,000 to 5,00,000: 5%
- Rs: 5, 00,000 to 10,00,000: 20%
- Above Rs: 10,00,000: 30%

B) Individual- Senior citizen (60 years or more but less than 80 years):

- Up to Rs: 3,00,000: Nil
- Rs: 300,000 to 5,00,000: 5%

Rs: 5, 00,000 to 10,00,000: 20%

Above Rs:10,00,000: 30%

C) Individual- Super senior citizen (80 years or more):

Up to Rs: 5,00,000: Nil

Rs: 5, 00,000 to 10,00,000: 20%

Above Rs: 10,00,000: 30%

3. Rebate u/s 87A. In case of resident individuals, a rebate of Rs 12500 or tax calculated whichever is less, shall be allowed provided their total income does not exceed Rs 5,00,000.
4. Surcharge- if total income exceeds Rs 1 crore surcharge @ 10% of tax shall be added.
5. Education cess- add education cess to the tax calculate above. Education cess @ 2% and SHEC @ 1%.
6. After adding education cess, rebates u/s 86 and relief u/s 89(1) are allowed.
7. Balance is tax payable which will be rounded off to the nearest multiple of Rs 10.

PROBLEMS

ILLUSTRATION I:

| | |
|---|-------|
| Compute the total income of Mr. Ram from the particulars given below: | Rs. |
| i) Interest on securities | 27000 |
| ii) Rental Value of a house Rs 7500 p.m. self-acquired but transferred to HUF Pool. Computed income from this house is | 25200 |
| iii) Share from firm assessed u/s 184 in which he has 1/3 rd share | 45000 |
| iv) Commission received by his wife from above mentioned firm for acting as its selling agent | 25000 |

SOLUTION:

| Computation of Total Income of Mr. Ram | Rs. | Rs. |
|--|-----|-----|
| Profits and Gains | | |

1/3rd Share from the firm assessed u/s 184 (Exempted) Nil

Other Sources:

| | | |
|---|--------------|--------------|
| a) Commission received by wife from a firm in which spouse has substantial interest u/s 64(1)(ii) | 25000 | |
| b) Income from self- acquired asset converted into common pool of HUF u/s 64(2) | 25200 | |
| c) Interest on Securities | <u>27000</u> | |
| 77200 | | |
| Total Income | | <u>77200</u> |

ILLUSTRATION II

For the accounting year ended 31st, March 2021 Mr. Shashi Kant furnishes the following particulars of his Income.

| | |
|--|--------|
| i) Salary received in India | 60000 |
| ii) Profit from business in Germany but received in India | 15000 |
| iii) Income from house property in Pakistan deposited in bank there | 12000 |
| iv) Profit from business established in Bangladesh but business is controlled from India | 46000 |
| v) Income accrued in India but received in Sweden | 25000 |
| vi) In this accounting year Mr. Shashi Kant has brought into India foreign income of earlier years | 42700 |
| vii) Profit from sale of plant at Mumbai (50% received in Bangkok) | 160000 |
| viii) Interest on japan development bonds (60% received in India) | 100000 |

compute his total Income if

a) *He is resident,*

b) *He is not ordinarily resident, or*

c) *He is non-resident.*

SOLUTION

Calculation of Total Income of Mr. Shashi Kant

Resident Not ordinarily Non-Resident

| | | Resident | |
|--|----------|----------|----------|
| a) Income accrued and received in India | | | |
| <i>Salary received being salary income</i> | 60000 | 60000 | 60000 |
| b) Income accrued in India but received outside India | | | |
| <i>i) Income accrued in India</i> | 25000 | 25000 | 25000 |
| <i>ii) Profit from sale of plant</i> | 160000 | 160000 | 160000 |
| c) Income accrued outside India but received in India | | | |
| <i>i) Profit from business in Germany but received in India</i> | 15000 | 15000 | 15000 |
| <i>ii) Interest on Japan Development Bonds</i> | 100000 | 60000 | 60000 |
| d) Income accrued and received outside India | | | |
| <i>i) Income from house property in Pakistan</i> | 12000 | — | — |
| <i>ii) Profit from business establishment in Bangladesh</i> | 46000 | 46000 | — |
| <i>iii) Foreign income of past previous years brought into India during the year</i> | — | — | — |
| Grand Total Income & Total Income | 3,20,000 | 4,18,000 | 3,66,000 |

ILLUSTRATION III

Mr. Verma is the manager of Punjab Cotton Mills Ltd. He draws a salary of Rs. 30000 p.m. His other items of income are:

- a) Interest on fixed deposits with Andhra Bank Rs. 10800 and interest credited in the savings a/c in the bank Rs. 12000.
- b) Winning from Lottery Rs. 60000.
- c) Dividend from an Indian Company Rs. 3600.
- d) Long term capital gains from sale of his residential house, occupied for the last 20 years Rs. 115000.

e) Short Term capital loss Rs. 10000.

f) Long term capital loss from Gold brought forward from the assessment year 2015-16 Rs. 20000.

The following deductions are claimed:

i) Life Insurance premium (policy for 100000 taken 2005) Rs. 14500.

ii) Donation for Punjabi University Rs. 5000.

iii) Donation to clean Ganga fund setup by Central Govt. Rs. 5000.

iv) Education of his children Rs. 4500.

Compute his total income and Tax payable for the assessment year 2021-22

SOLUTION

Computation of Total Income

| Salaries | Rs. | Rs. |
|--|-------------------|---------------|
| Salary @ 30000 p.m | 3,60,000 | |
| Deduction u/s 16 | <u>NIL</u> | |
| | | 3,60,000 |
| Capital Gains | | |
| L.T.C from house | 1,15,000 | |
| Less: Exemption u/s 54 | <u>1,05,000</u> | |
| 10000 | | |
| Set off S.T.C. Loss of the same year | <u>10000</u> | |
| Nil | <u> </u> | |
| L.T.C Loss b/f still to be c/f 10000 | Nil | |
| | <u> </u> | |
| Other Sources | | |
| Interest on fixed deposit with bank | 10800 | |
| Interest on savings a/c with the bank | 12000 | |
| Winning from Lottery | 60000 | |
| Dividend from indian company: Exempted | <u>Nil</u> | <u>82,800</u> |
| Gross Total Income | | 4,42,800 |
| Deduction u/s 80 | | |
| i) u/s 80 C: Q.A of savings | 14500 | |

| | | |
|---|--------------|-----------------|
| ii) u/s 80 G: Donation to a university Rs.5000, Q.A= 100% | 5000 | |
| Donation to clean Ganga Fund Rs. 5000, Q.A= 100% | 5000 | |
| iii) u/s 80TTA: Interest in savings a/c-restricted to 10000 | <u>10000</u> | <u>34,500</u> |
| Total Income | | <u>4,08,300</u> |

Computation of Tax liability

| | | |
|--|---------------------|-----------------------------|
| Lottery Income Rs. 60000@30% | | 18000 |
| Other Income (4,08,300-60000)=348,300 | | |
| On 2,50,000 | Nil | |
| On balance Rs. 98,300@5% | <u>4915</u> | |
| Tax | | <u>4915</u> |
| 22,915 | | |
| Less rebate u/s 87A | | <u>2000</u> |
| 20,915 | | |
| Add: Education Cess@ 2%of tax | 418.3 | |
| Secondary and higher education Cess @ 1% | <u>209.15627.45</u> | |
| Total tax | 21542.45 | <u> </u> |

Tax Payable rounded off to 21,540

3.8 CONCEPT OF HINDU UNDIVIDED FAMILIES

The term 'Hindu undivided family' has not been defined in the Income-tax Act. However, in general parlance it means an undivided family of Hindus. Creation of a HUF is a God-gifted phenomenon. As soon as a married Hindu gets a child, a new HUF comes into existence. It is not at all necessary that every HUF must have joint property or family income. [R.SubramaniaIyer v. CIT (1955) 28, ITR, 352]. However, to become an assessee under the Income-tax Act, there must be 'income-yielding' joint property of the family.

A HUF may consist of a number of smaller HUFs. A smaller HUF has a legal existence and may be assessable as a unit distinct from the apex joint family even when the bigger HUF is in place [CIT v. Khanna (1963) 49 ITR 232].

Under Hindu Law, a Joint Hindu Family consists of all persons lineally descended from a common ancestor (except those who have separated from the joint family by partitioning of assets) and includes their wives and unmarried daughters, and also a stranger who has been adopted by the family. [Surjit Lal Chhabra v. CIT (1975) 101, ITR, p.776 (S.C.)].

The Supreme Court's decision in the case of Surjit Lal Chhabra v. CIT (1975 101 ITR 776) has come to stay as one of the leading case laws. The ratio laid down by the Supreme Court had been applied by the Andhra Pradesh, Orissa and Madras High Courts, followed by Bombay, Patna, Madhya Pradesh and Delhi High Courts and relied upon by the Punjab High Court. In the latest case, the Delhi High Court held in Commissioner of Income-tax v. S.P. Chopra (1991, 191 ITR 455) that the income from the half share of the property had to be treated as the individual income of the assessee under the personal law and not as income of the family. The character of the property had to be determined in accordance with the personal law of the assessee and not on the basis of how the property had been treated by the revenue in respect of earlier assessments.

A son conceived or in his mother's womb is equal in many respects to a son actually in existence, viz., inheritance, partition, survivorship etc. But this doctrine does not apply to the Income-tax Act. Hence, a son conceived is not treated a member of the H.U.F. for Income-tax purposes. [T.S. Srinivasan v. C.I.T., (1966) 60, ITR, p.36 (S.C.)].

Jain and Sikh undivided families are also treated as Hindu undivided families unless, under special circumstances, the assessee claims not to be treated as such. If such claim is made, the assessee shall have to prove that there is some such custom in his family on account of which it cannot be treated as a Hindu undivided family.

A Hindu does not cease to be a Hindu merely because he declared for the purpose of the Special Marriage Act, 1872, that he does not profess Hindu Religion. Such a Hindu does form an H.U.F. with his children from such marriage. [CIT v. Partap Chand (1959), 36 ITR, 262]. Similarly, a Muslim family governed by the Marumakkathayam law constitutes 'Tarwad' or 'Thavazhi' and falls within the definition of a H.U.F. [V.K.P. Abdul Kadar Haji v. Ag. ITO (1967) 66, ITR, 173].

If a Hindu gets converted as a Christian, the family of such a person will not be a HUF. However a Hindu, along with his son (by a christian wife) who has been brought up as a Hindu will be a HUF. [CWT v. R. Sridharan (1976) 104, ITR, 436 (S.C.)].

3.9 TYPES OF MEMBERS

A Hindu Joint Family consists of two types of members:

(i) Coparceners: The lineal male descendants of a person up to the third generation of such person are known as coparceners. The coparceners acquire, on birth, ownership in the ancestral properties of such ascendant and have a right to claim partition of such property at any time. However, w.e.f. 9.9.2005 due to amendment of Hindu Succession Act, the daughter of a coparcener shall by birth become a coparcener in her own right in the same manner as the son. Hence, the daughter can also ask for partition.

(ii) Other members: Such members include wives of male members of the family and other male members.

Thus, a Hindu Joint Family may consist of:

(a) All persons lineally descended from a common ancestor and includes their wives and daughters (w.e.f. 9.9.2005).

(b) A male and widow or widows of deceased male member or members. [GowliBuddanna v. C.I.T. (1966) 60, ITR, p. 293 (S.C.)]

However, an unmarried coparcener who receives share on the partition of joint family properties, cannot form a Hindu undivided family unless he marries. After his marriage, he can hold the property received from family as joint family property consisting of himself and his wife. [C. Krishna Prasad v. C.I.T. (1974) 97, p. 493 (S.C.)].

Karta: Property of the family is ordinarily managed by the father or other senior member for the time being of the family. He is called Karta. However, the senior member may give up his right of management and a junior member may be appointed as Karta with the consent of all other members. [Narendra Kumar J. Modi v. CIT (1976) 105, ITR, 109 (S.C.)]. In the absence of a male member in the family or when all male members are minors, a woman member can be treated as manager of the family for income-tax purposes. [Smt. ChampaKumariSinghi v. Addl. Member of the Board of Revenue (1962) 46, ITR, p. 81].

Since daughter is also a coparcener w.e.f. 9.9.05, it may be presumed that daughter can also be karta of her father's HUF.

3.10 JOINT PROPERTY OF THE FAMILY

It consists of:

(i) Ancestral property;

(ii) Accretion thereto;

(iii) Acquisition with joint funds; and

(iv) Self-acquired property of any member thrown by him into the common stock to be treated as family property. In the case of *Pushpa Devi v. C.I.T.* the Supreme Court has held that a Hindu female, not being a coparcener, cannot blend her separate property with Joint family property. However, she can make a gift of her property to the family. [(1977) 109, ITR p. 730].

The Supreme Court's decision in the case of *Pushpa Devi v. Commissioner of Income-tax* (1977, 109 ITR 730) had been later followed by the Calcutta, Andhra Pradesh and Madras High Courts. In the latest case, the Madras High Court held in the case of *RajathyAmmal v. Commissioner of Wealth-tax* (1987, 164 ITR 605) that a female member could not throw her property into the family hotchpotch and the only way she could achieve her purpose was either by gifting it or selling to the family.

Further, Section 64(2) provides that where an individual being a member of Hindu undivided family transfers his separate property after 31st December, 1969 to the family for the common benefit of the family, otherwise than for adequate consideration, such property is known as converted property. The income derived from the converted property or any part thereof shall be included in the total income of the transferor individual and not in the income of the family.

School of Hindu Law: According to Hindu Law, HUFs are governed by two schools viz. **Mitakshara and Dayabhaga.**

Mitakshara School applies to whole of India except the states of West Bengal and Assam.

Dayabhaga School applies to the States of West Bengal and Assam. The difference between the two schools is as under:

(i) Foundation: In the Mitakshara School, the foundation of a coparcenary is laid down when a son is born to the Mitakshara father. Under the Dayabhaga School the foundation of a coparcenary is laid on the death of the father leaving, as survivors, one or more sons.

(ii) Right to partition: A Mitakshara son, in whom the interest in family property is vested by birth, all along possesses a right to demand partition. A Dayabhaga son, on the other hand acquires no interest in the family property by birth and, consequently, has no right to demand partition of the HUF property from his father.

(iii) Quantum of share: Under Mitakshara Law, each coparcener takes as undefined share in the coparcenary property. The share of the members decreases by birth in the family and increases upon death of a coparcener. A Dayabhaga coparcener, on the other hand, always takes a defined share in the property left by his deceased father. Thus, the heirs of a deceased governed by the Dayabhaga School do not constitute a HUF automatically on the death of the deceased and cannot be assessed as a HUF unless they have by mutual consent agreed to form a joint family.

(iv) Gift out of ancestral property: A Mitakshara Karta may make a gift of movable property of the family, out of love and affection, within reasonable limits. He can also make a gift of immovable properties, within reasonable limits for pious purposes; i.e., for charitable and religious purposes or to a daughter in fulfilment of a nuptial promise etc. However, a gift to a stranger is void. On the contrary, a Dayabhaga father can alienate ancestral property, both movable as well as immovable, by sale, gift, will or otherwise in the same way as he can dispose of his separate property.

3.11 POSITION UNDER HINDU SUCCESSION ACT, 1956

This Act came into force on and from 17th June, 1956. It lays down a uniform and comprehensive system of inheritance and applies to persons governed by the Mitakshara as well as the Dayabhaga Schools, superseding and abrogating all previous law or customs or usage having the force of law. Under this Act, the heirs of a male Hindu dying intestate on or after 17th June, 1956 are divided into three classes. Class I heirs get the right to the deceased's property simultaneously to the exclusion of all other Classes of heirs. Class II relations succeed only if there is no class I relation and, the heirs in the first entry of class II being preferred to heirs in the second entry, and so on, but heirs in any one entry taking in equal shares amongst themselves.

The students should note that Section 4 of the Hindu Succession Act, 1956 clearly lays down that “save as otherwise expressly provided in the Act, any text, rule or interpretation of Hindu Law or any custom or usage as part of that law in force immediately before the commencement of the Act shall cease to have effect with respect to any matter for which provision is made in the Act.” And, Section 8 of the

Hindu Succession Act, 1956, lays down the scheme of succession to the property of a Hindu dying intestate. The schedule classifies the heirs on which such property shall devolve.

The preferential heirs of class I are as under:

(1) Son (2) Daughter (3) Widow (4) Mother (5) Son/daughter/widow of a predeceased son (6) son/daughter of a predeceased daughter (7) Son/daughter/ widow of a predeceased son of a predeceased son.

A son's son is not mentioned as an heir under Class I of the schedule and, therefore, he cannot get any right in the property of his grandfather under the provision. The right of a son's son in his grandfather's property during the lifetime of his father which existed under the Hindu Law as in force before the Act, is not saved expressly by the Act and, therefore the earlier interpretation of Hindu Law giving a right by birth in such property 'ceased to have effect'.

Therefore, the property which devolves on a Hindu on the death of his father intestate after coming into force of the Hindu Succession Act, 1956, does not constitute H.U.F. property consisting of his own branch including his sons. [Shri VallabhdasModani v. C.I.T. (1982) 138, ITR, p. 673].

The Allahabad High Court's decision supra in the case of Shri VallabhdasModani v. Commissioner of Incometax was followed by the Andhra Pradesh High Court (1983, 144 ITR 18) and later approved by the Supreme Court in the case of Commissioner of Wealth-Tax v. Chander Sen (1986, 161 ITR 370) holding that it is not possible to say that when a son inherits the property in the situation contemplated by the Hindu Succession Act, 1956, he takes as Karta of his own undivided family.

3.12 COMPUTATION OF INCOME OF THE H.U.F.

The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assesseees. However, in this connection the following points are worth noting:

Clubbing of Income

- (i) If the funds of a Hindu Undivided family are invested in a company or a firm, fees or remuneration received by the member as a director, or a partner in the company or firm may be treated as income of the family in case the fees or remuneration is earned essentially as a result of investment of funds. But, if the fees or remuneration is earned essentially for services rendered by

the member in his personal capacity, the income shall constitute the personal income of the member.

(ii) For determining whether a particular income belongs to a member of the family or to his undivided family, the Supreme Court has enunciated certain principles. The question to be considered in such cases is, whether the remuneration received by the coparcener is in substance merely a mode of return made to the family because of the investment of the family funds in the business or whether it is a compensation for services rendered by the coparcener. If it is the former, it is an income of the HUF but if it is the latter it is the income of the individual. If the income was essentially earned as a result of the funds invested, the fact that a coparcener has rendered some service would not change the character of the receipt. But if, on the other hand, it is essentially a remuneration for the services rendered by the coparcener, the circumstances that his services were availed of because of the reason that he was a member of the family which had invested funds in that business or that he had obtained the qualification shares from out of the family funds would not make the receipt the income of the HUF. [Raj Kumar Singh HukamChandji v. CIT (1970) 78 ITR 33].

The Supreme Court's decision supra in the case of Raj Kumar Singh HukamChandji v. Commissioner of Income-tax has come to stay as one of the most followed/applied case laws. This decision had been followed by Patna (Full Bench), Allahabad, Bombay and Gujarat High Courts, applied by Andhra Pradesh, Madras, Kerala, Delhi, and Supreme Court itself. It would suffice to refer to the Supreme Court's decision in the case of Y.L. Aggarwalla and others v. Commissioner of Income-tax (1978, 114 ITR 471) holding that the share income was a return made to the family because of the investments of the family funds in the business and the share income was not the individual income of minor sons but was the income of the Hindu undivided family and had to be assessed in the hands of the family.

(iii) Where a member of a HUF is a partner in a firm on behalf of the family and on partition of the property of the family, the share in the firm is allotted to such a member, subsequent to such allotment when the firm settles its accounts the whole income for that year would be the income of the individual member and no part of the income would be added to the income of the family. [CIT v. Ashok Bhai Chiman Bhai (1965) 56, ITR, 42 (S.C.)].

(iv) The personal earning, including income from self-acquired property of a member of the HUF, even though he has sons, would not be included in the income of the family. Such income shall be assessed as income of that individual. [KalyanjiVithal Das v. CIT (1937) 5 ITR 90 (PC)].

(v) Any sum paid by an H.U.F to a member of the family out of its income is not deductible in computing the income of the family. However, such amount will not be included in the income of such individual whether the family had paid tax on its income or not [Section 10(2)].

(vi) If any remuneration is paid by the Hindu Undivided family to the karta or any other member for services rendered by him in conducting family's business, the remuneration is deductible if remuneration is (a) paid under a valid and bona fide agreement; (b) in the interest of, and expedient for, the business of family; and (c) genuine and not excessive. Jugal Kishore BaldeoSahai v. CIT [1967] 63 ITR 238 (SC).

(vii) If salary is paid by the Hindu undivided family to its karta for looking after its interest in firms in which it is partner through said karta, such salary is allowable as deduction - CIT v. Prakash Chand Agarwal [1982] 11 Taxman 55 (MP).

(viii) Income from 'stridhan' is not includible in the income of the family. Property derived by a woman from her father or brother or husband or any other relative either before or after her marriage is known as 'stridhan'.

(ix) If a member has converted or transferred without adequate consideration after December 31, 1969 his self-acquired property into joint family property, income from such property is not taxable in the hands of the family.

(x) Income from impartible estate is taxable in the hands of the holder of the estate and not in the hands of the Hindu undivided family. Though, the impartible estate belongs to the family, income arising therefrom belongs to the holder of the estate who is the senior most male member of the family. Income from impartible estate is taxable in the hands of the holder of the estate.

(xi) Personal income of the members cannot be treated as income of Hindu undivided family.

(xii) Under the DayabhagaSchool of law, as stated in a preceding page, no son has any right in the ancestral property during the lifetime of his father. If, therefore, the father does not have any brother as a coparcener, income arising from ancestral property is taxable as his individual income.

3.13 PARTITION OF A HINDU UNDIVIDED FAMILY (Section 171)

‘Partition’ signifies division of property. In the cases of property capable of physical division, share of each member is determined by making physical division thereof. It must be noted that a division of income without physical division of property does not amount to partition. Where, however, the property is not capable of physical division, partition implies such division as the property may admit.

- ***Who is entitled to share on partition***

Though only coparceners can demand partition, once the partition takes effect, the following persons are entitled to a share:

- (a) All coparceners;
- (b) A son in the womb of his mother at the time of partition;
- (c) Mother, who gets an equal share if the partition takes place among her sons after the death of her husband; and
- (d) Wife, who gets a share equal to that of a son at the time of a partition between father and sons.

- ***Assessment after partition (Section 171)***

A joint family, once assessed as a HUF, continues to be assessed as such till one or more coparceners claim partition. Such claim must be made by the coparceners before the assessment of the income of the HUF for the relevant assessment year is completed. On the receipt of such a claim, the Assessing Officer must make an inquiry after giving due notice to the members and record a finding whether there has been a partition and, if so, the date of the partition. The income of the family from the first day of the previous year to the date of partition is assessed as income of the HUF and from the next date of the partition to the date of close of the previous year, as the individual income of the recipient-members. If the recipient member forms another HUF along with his wife and son(s), the income of the property which was subject to partition is chargeable to tax in the hands of the new H.U.F.

- ***A partition of the HUF can be both total and partial***

Where the entire joint family property is divided among all coparceners and the family ceases to exist as an undivided family, the partition is total. A partial partition may be as regards: (a) the persons constituting the joint family, or (b) the properties belonging to the joint family, or (c) both. The device

of partial partition has been used as a medium for reduction of proper tax liability. To curb such a practice, the Finance (No. 2) Act, 1980 inserted Sub-section 9 in Section 171 which lays down that partial partitions of HUFs effected after 31st Dec., 1978 will not be recognised for tax purposes.

The provisions made by Sub-section (9) in Section 171 are as follows:

(i) In a case where a partial partition of a HUF has taken place after 31.12.1978, no claim of such partition will be enquired into and the Assessing Officer will not record a finding as to whether there has been a partition of the family property. Further, any finding regarding partial partition recorded under Section 171(3) will be null and void and of no legal effect.

(ii) Such family will continue to be assessed as if no such partial partition has taken place, i.e., the property or source of income will be deemed to continue to belong to the Hindu undivided family and no member will be deemed to have separated from the family.

(iii) Each member or group of members of such family will be jointly and severally liable for any tax, interest, penalty, fine or other sum payable under the Act by the family, whether before or after such partition. The several liability of any member or group of members of such family will be computed according to the portion of the joint family property allotted to him on such partial partition. This amendment has come into force with effect from April 1, 1980 and has, accordingly, been applicable with effect from assessment year 1980-81 and onwards.

3.14 SUMMARY

An income tax is a tax imposed on individuals or entities (taxpayers) that varies with the income or profits (taxable income) of the taxpayer. Details vary widely by jurisdiction. Many jurisdictions refer to income tax on business entities as companies tax or corporate tax. Income tax generally is computed as the product of a tax rate times taxable income. The tax rate may increase as taxable income increases (referred to as graduated rates). Taxation rates may vary by type or characteristics of the taxpayer. Capital gains may be taxed at different rates than other income. Credits of various sorts may be allowed that reduce tax. Some jurisdictions impose the higher of an income tax or a tax on an alternative base or measure of income.

Individual income tax is a subject matter of central govt. If an individual want to assess his/her income tax then he/she should have knowledge of individual income tax structure. Individuals after calculating

their total income for a particular financial year can assess their income tax after deduction of saving and doing other adjustments. By doing so they can plan in advance about their savings and income tax.

Income tax is levied on an assessee's total income. Such total income has to be computed as per the provisions contained in the Income-tax Act, 1961. The procedure of computation of total income for the purpose of levy of income tax starts with the determination of residential status of Individual. The residential status of a person has to be determined to ascertain which income is to be included followed by the classification of income under various heads. The Act prescribes five heads of income. These heads of income exhaust all possible types of income that can accrue to or be received by an individual. An individual has to classify the income earned by him under the relevant head of income then exclusion of exempted income takes place as there are certain incomes which are wholly exempt from income tax e.g., income from mutual fund. These incomes have to be excluded and will not form part of GTI. The balance income over and above the prescribed limits would enter computation of total income and have to be classified under the relevant head of income. After the calculation of GTI under each head, net income under each head is computed and then incomes are clubbed and if there is some losses which are to be setoff and forwarded are accordingly dealt with. After following all these steps we compute Gross Total Income, deduction from Gross Total Income and the finally computation of total income takes place.

A joint family or undivided family is an extended family arrangement prevalent throughout the Indian subcontinent, particularly in India, consisting of many generations living in the same household, all bound by the common relationship.

Historically, for generations India had a prevailing tradition of the joint family system or undivided family. The system is an extended family arrangement prevalent throughout the Indian subcontinent, particularly in India, consisting of many generations living in the same home, all bound by the common relationship. A patrilineal joint family consists of an older man and his wife, his sons and daughters and his grandchildren from his sons and daughters.

The family is headed by a senior person called a karta, usually the oldest male, who makes decisions on economic and social matters on behalf of the entire family. The patriarch's wife generally exerts control over the household and minor religious practices and often wields considerable influence in domestic matters. Family income flows into a common pool, from which resources are drawn to meet the needs of all members, which are regulated by the heads of the family. However, with urbanisation and economic

development, India has witnessed a break up of traditional joint family into more nuclear-like families, and the traditional joint family in India accounted for a small number of Indian households

A Hindu undivided family or HUF is a legal term related to the Hindu Marriage Act. The female members are also given the right of share to the property in the HUF. The term finds reference in the provisions of the Income Tax Act, but the expression is not defined in the act. There are various aspects of Hindu law relevant for the purpose assessment of income and wealth in the status of HUF, as well as the impact of the provisions of Hindu Succession Act 1956 as amended by Hindu Succession (Amendment) Act 2005 relevant for the purpose of assessment of income and wealth in the status of HUF under the Income Tax Act 1961.

In the case of Surjit lal Chhabra 101 ITR 776 SC, joint family and undivided family are synonymous: "A joint Hindu family consists of persons lineally descended from a common ancestor and includes their wives and unmarried daughters. The daughter, on marriage, ceases to be a member of her father's family and becomes a member of her husband's family."

In 2016, a judgment of the Delhi High Court ruled that the eldest female member of a Hindu Undivided Family can be its "karta" (manager)

ILLUSTRATION I

A HUF with more than one coparcener entitled to claim partition, owns a property which is let out at Rs. 600 per month per unit. The property consists of ten identical residential units. Following deductions are claimed by the HUF including the expenses on tenant's amenities.

| | |
|---|--------|
| Municipal rental Value for ten units(annual) | 60,000 |
| Municipal taxes | 4200 |
| Lift Maintenance | 2000 |
| Water pump expenses | 800 |
| Actual expenses on repairs | 8000 |
| Renovation to the property during the year | 50,000 |
| Edu. Cess levied by the state Govt. | 2000 |
| Rent collectors salary per month | 200 |
| Interest on loan taken against mortgage of the property but The money was actually used in the business of the HUF | 5000 |

The income from business for the assessment year 2016-17 2,10,000

(After charging interest on loan)

A lottery ticket of 100 Rs. Was purchased out of family funds on the name of HUF and it won a prize of Rs. 100000. The Karta has acquired a shop out of his own savings which he gifted to his wife. Shop has an annual income of Rs 24000.

Compute the HUF's total income and tax payable for the assessment year 2021-22

SOLUTION

Computation of total income of HUF

| | | |
|--|--------------|-----------------|
| Income from House Property | Rs | |
| Rental value of 10 units for 12 months | 72,000 | |
| Less: Cost of facilities borne by the owner: | | |
| Lift maintenance | 2000 | |
| Water pump expenses | 800 | |
| | 2800 | |
| Annual Rent | 69,200 | |
| Or | | |
| Municipal Rental Value | 60,000 | |
| Whichever is higher is ARV | <u>69200</u> | |
| Less: Municipal taxes | 4200 | |
| Net Annual Value | <u>65000</u> | |
| Ded. u/s 24 | <u>19500</u> | |
| Standard deduction= 30% of NAV | | 45,500 |
| Profits and gains: Business Profit | | 2,10,000 |
| Other Sources: Lottery | | 100000 |
| GTI as Total Income | | <u>3,55,500</u> |
| Computation of tax: | | |
| Tax on lottery income (30% of 1,00,000) | | |
| 30,000 | | |
| Tax on other income(3,55,500 - 100000)= 2,55,000 | | |
| On 250000 | | Nil |

| | | |
|-------------------------------------|---------------|-----------------|
| On 5500 @ 5% | <u>275</u> | <u>275</u> |
| Tax | | 30,275 |
| Add: Edu. Cess @2% of Tax | 605.5 | |
| Secondary and higher edu. Cess @ 1% | <u>302.75</u> | 908.25 |
| Total Tax | | <u>31183.25</u> |

Total tax rounded off Rs. 31180.

ILLUSTRATION II

The following particulars have been submitted by ram Lal in the capacity of Karta of a HUF for assessment purposes:

- a) Profit from families' business, Rs. 25000 after charging an amount of Rs. 60,000 given as salary to Karta's brother who has been actively participating in it.
- b) Salary income of Kartas another brother who is manager in a cooperative bank Rs. 11000 p.m.
- c) Directors fees received by Karta Rs. 5000(HUF holds 20% shares in this company).
- d) Bank interest on fixed deposits 24000.
- e) Long term capital gain from the transfer of building 28000.
- f) Long term capital gain from the transfer of investment 40000.
- g) Donation to a college which is an approved institution 40000.
- h) Rental value of the property let 36000.
- Municipal taxes paid in respect of the house 4500.
- Interest on loan taken for repair of house 12000.

You are required to calculate total income and tax liability of the family for the assessment year 2020-21.

SOLUTION:

Computation of income of HUF managed by Karta Ram Lal.

| I. Income from house property: | Rs. | Rs. |
|--------------------------------|--------------|-----|
| Annual rental Value | 36000 | |
| Less: Municipal taxes | <u>4500</u> | |
| N.A.V | 31500 | |
| <i>Less: Ded. U/s 24:</i> | | |
| 30% of NAV | 9450 | |
| Interest on loan | <u>12000</u> | |

| | | |
|---|--------------|---------------|
| | | 10500 |
| II. Profits and gains of business and profession: | | |
| Profit from family business | | 250000 |
| III. Capital Gain: Long Term | | |
| Transfer of building | 28000 | |
| Transfer of other assets | <u>40000</u> | 68000 |
| IV. Income from other sources: | | |
| Bank interest (fixed deposit) | 24000 | |
| Directors remuneration (assumed as HUF income) | <u>5000</u> | <u>29000</u> |
| Gross Total Income | | 3,57,050 |
| Ded. U/s 80: | | |
| 80G: Donation 40000: Q.A restricted to 10% of G.T.I | | |
| [357050-68000=289050] | | |
| Q.A 28905 Rate 50% | | <u>14453</u> |
| Total Income | | <u>342597</u> |

Rounded off to Rs. 342600

Tax Liability:

| | | |
|---|-------------|--------------|
| Total Income = 342600 | | |
| Tax on long term capital gain (68000 @ 20%) | | 13600 |
| On balance income (342600-68000) = 274600 | | |
| Tax on Rs. 250000 | Nil | |
| On balance Rs. 24600 @ 5% | <u>1230</u> | <u>1230</u> |
| Tax | | 14830 |
| Add: Edu. Cess @ 2% | | <u>593</u> |
| Tax Payable | | <u>15423</u> |
| Tax payable rounded off Rs. 15270 | | |

3.15 GLOSSARY

- Individual includes both male and female assesseees. The total income has to be computed as per the provisions of the Income-tax Act, 1961. In addition to individuals own income, income of other persons received by him in some other capacity or received by other persons is to be

clubbed with individual assessee's income. Following steps are considered for computing total income and to charge tax.

- The term 'Hindu undivided family' has not been defined in the Income-tax Act. However, in general parlance it means an undivided family of Hindus. Creation of a HUF is a God-gifted phenomenon. As soon as a married Hindu gets a child, a new HUF comes into existence. It is not at all necessary that every HUF must have joint property or family income.
- A Hindu Joint Family consists of Coparceners & members.
- The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assessee's.
- 'Partition' signifies division of property. In the cases of property capable of physical division, share of each member is determined by making physical division thereof. It must be noted that a division of income without physical division of property does not amount to partition.
- Income tax has to be paid by every individual person, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals (BOI), corporate firms, companies, local authorities and all other artificial juridical persons that generate income.
- Coparceners: The lineal male descendants of a person upto the third generation of such person are known as coparceners. The coparceners acquire, on birth, ownership in the ancestral properties of such ascendant and have a right to claim partition of such property at any time.
- Hindu Succession Act, 1956: This Act came into force on and from 17th June, 1956. It lays down a uniform and comprehensive system of inheritance and applies to persons governed by the Mitakshara as well as the Dayabhaga Schools, superseding and abrogating all previous law or customs or usage having the force of law.
- **Karta:** Property of the family is ordinarily managed by the father or other senior member for the time being of the family. He is called Karta. However, the senior member may give up his right of management and a junior member may be appointed as Karta with the consent of all other members. [Narendra Kumar J. Modi v. CIT (1976) 105, ITR, 109 (S.C.)].
- Where a member of a HUF is a partner in a firm on behalf of the family and on partition of the property of the family, the share in the firm is allotted to such a member, subsequent to such allotment when the firm settles its accounts the whole income for that year would be the income of the individual member and no part of the income would be added to the income of the family

3.16 SELF-ASSESSMENT QUESTIONS

1. Discuss the concept of Individual assessee?

2. Discuss the meaning of Hindu Undivided Family?

3. Explain the need and importance of Assessment?

4. List the steps to be followed while computing Total income of the assessee?

5. What are the steps to be considered for computing total income and to charge tax?

6. What do you mean by Partition of a Hindu undivided family? Who is entitled to share on partition?

7. List the Income of other persons to be included in the total income of an individual?

8. What is Karta?

9. Explain the various steps to be followed while computing the taxable income of Hindu Undivided Family?

3.17 BOOKS RECOMMENDED

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. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.
4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.
5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.
6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.
7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

ASSESSMENT OF FIRMS AND ASSOCIATION OF PERSONS INCLUDING COMPUTATION OF TAX LIABILITY

STRUCTURE:

- 4.1 Introduction
- 4.2 Objective
- 4.3 Taxation of Firms
- 4.4 Scheme of taxation of a firm and its partners
- 4.5 Change in Constitution of a Firm (Section 187)
- 4.6 Losses of Registered Firms (Section 75)
- 4.7 Succession of one firm by another firm (Section 188)
- 4.8 Computation of income on estimated basis in case, taxpayers are engaged in certain business
- 4.9 Other Provisions relating to Limited Liability Partnership
- 4.10 Alternate Minimum Tax (AMT) (Section 115JC)
- 4.11 Association of Persons
- 4.12 Formation of an Association of Persons
- 4.13 Tax Liability of Association of Persons
- 4.14 Method of Computing Share of a Member of Association of Persons, etc. (Section 67A)
- 4.15 Tax on Income of association of persons, etc. which is indeterminate or unknown.
- 4.16 Share of a member of association etc. (Section 86)
- 4.17 Summary
- 4.18 Glossary
- 4.19 Self-Assessment Questions
- 4.20 Books Recommended

4.1 INTRODUCTION

Assessment is the act of judging or deciding the amount, value, quality, or importance of something, or the judgment or decision that is made. It is a procedure used by government assessors to determine the value of a property, or the income of a person or entity, in order to charge taxes or to levy on the orders of a court. In other words it is a value calculated as the basis for determining the amounts to be paid or assessed for tax or insurance purposes. A tax assessor is responsible for preparing and maintaining the assessment roll, the tax roll and collecting the tax levies in accordance with the quality standards.

The core service responsibilities include:

- Preparing annual market value assessments for all properties.
- Preparing the business assessment valuations for all business premises.
- Maintaining accurate property information and ownership on all realty accounts.
- Maintaining accurate business information and ownership on all business accounts.
- Defending assessments before municipal and provincial assessment tribunals.
- Responding to inquiries and requests for information related to assessment and taxation.
- Producing and mailing annual assessment and tax notices to tax payers.
- Reporting assessment rolls and meeting annual audits.

A partnership firm is a separate entity in the eyes of income tax department. It is so because the definition of the term 'person' given under section 2(31) also includes 'firm'. Though the income earned by firm is the joint income of the partners yet such income is taxable as the income of the firm. A firm is liable to pay tax at a flat rate (on normal income as well as on certain special incomes) without any basic exemption limit (as is there in case of individual and Hindu Undivided Family).

In this lesson the Income Tax Treatment with relation to Firms and Associations of Persons is being discussed. The tax implications, rates of tax and other issues relating to the above persons have been discussed elaborately. With regard to firms the focus is on partnership firms or Limited liability partnerships.

4.2 OBJECTIVE

At the end of this lesson, you will learn

- What is partnership firm
- What are the tax implications in the hands of partners and firm
- What are admissible expenses/inadmissible expenses while calculating the book profit of the firm.
- What are the provisions of Alternate Minimum Tax
- What do you mean by Association of Person.
- How Association of persons is formed
- What is the method of computation of share of a member of AOP?

4.3 TAXATION OF FIRMS

Under Section 2(23) of the Income-tax Act, the terms “firm”, “partner”, and “partnership” have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

The expression “partner” also includes a minor who has been admitted to the benefits of partnership and a partner of a Limited Liability Partnership Act 2008. However a minor cannot validly enter into any partnership as a ‘full partner’ with other persons but he can be admitted to the benefits of partnership only.

A joint Hindu family as such cannot be a partner in a firm. However, through its Karta it may enter into a valid partnership with a third person or with a member of the undivided family in his individual capacity. In such a case, the Karta occupies a dual position. On the partnership he functions in his individual capacity; on the relations to other members of the Hindu undivided family, in his representative capacity.

An incorporated company being a legal person may form a partnership with an individual or with another company. In considering the maximum number of partners comprising a firm, the company will be considered as one person only.

A partnership firm as such is not entitled to enter into a partnership with another firm, H.U.F., individual, or a company. However, its partners in their individual capacity can enter into another partnership.

4.4 SCHEME OF TAXATION OF A FIRM AND ITS PARTNERS

Assessment as a Firm (Section 184)

As per the scheme, a partnership firm in the first assessment year shall be assessed as a firm if the following conditions are satisfied:

1. The partnership is evidenced by an instrument i.e. partnership deed.
2. The individual shares of the partners are specified in that instrument.
3. A copy of the partnership deed certified by all the partners in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.

Where the return is made after the dissolution of the firm, the copy of the partnership deed should be certified in writing by all persons (excluding minors) who were partners of the firm immediately before its dissolution and by the legal representative of any deceased partner.

When a firm is assessed as such for any assessment year, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or in the shares of partners as evidenced by the partnership deed on the basis of which assessment as a firm was first sought.

Where any such change has taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for the assessment year relevant to such previous year. In doing so all the provisions of Section 184 will apply to the firm.

Circumstances where the firm will be assessed as a firm but shall not be eligible for deduction on account of interest, salary, bonus, etc.

Where the firm –

- (a) fails to make the return required under Section 139(1) and has not made a return or revised return under Section 139(4) or 139(5), or

(b) Fails to comply with all the terms of a notice issued under Section 142(1) or fails to comply with a direction issued under Section 142(2A), or

(c) Having made a return, fails to comply with all the terms of a notice issued under Section 143(2),

(d) Does not comply with three conditions mentioned above u/s 184.

Then the firm shall not be eligible for any deduction on account of interest to a partner and remuneration to a working partner although the same is mentioned in the partnership deed.

Rate of tax

In the case of a firm which is assessable as such (i.e. as a firm), tax is chargeable on its total income at the rate of 30%

Surcharge @10% shall be applicable where the total income exceeds ` 1 crore.

Partnership is not a separate entity distinct from the partners, but for tax purposes a partnership is taxed as a separate entity and therefore total income will be computed under various heads of income. A partnership firm is also entitled for deductions under section 30 to 37 for expenditures incurred. However, for payment of remuneration to partners and interest on capital are allowed subject to conditions laid down under section 40(b).

Section 40(b), contain the following conditions which need to be complied with while making payment of remuneration and interest on borrowed capital to the partners:

(i) Payment of salary, bonus, commission or remuneration by whatever name called to a non-working partner shall not be allowed as deduction. Such payments are allowed only to working partners if it is authorised by and is in accordance with partnership deed.

(ii) Interest payable to a partner, although authorised by the partnership deed shall be allowable as deduction subject to a maximum of 12% p.a. If the partnership deed provides for interest at less than 12% p.a, the deduction of interest shall be allowed to the extent provided by the partnership deed.

(iii) The payment of remuneration to working partner, although authorised by partnership deed however it is subject to maximum of the following limits.

| | |
|--|--|
| <i>Finance Act, 2009 provides for uniform limits for both professional firms and non-professional firms:</i> | |
| <i>I. On the first Rs. 3,00,000 of the book-profit or in case of a loss</i> | <i>Rs. 1,50,000 or 90% of the book-profit, whichever Is more</i> |
| <i>II. On the balance of the book-profit</i> | <i>60% of the book profits.</i> |

Meaning of Book Profit [Explanation 3 to section 40(b)]

Book-profit” means the net profit, as shown in the profit and loss account and make the additions and deductions as per section 28 to 44D explained under the head income from Business and Profession increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit. Interest paid/payable to partners in excess of 12% shall also be disallowed as per section 40(b).

4.5 CHANGE IN CONSTITUTION OF A FIRM (Section 187)

Where at the time of making an assessment under Section 143 or Section 144 of the Act it is found that a change has occurred in the constitution of a firm, the assessment will be made on the firm as constituted at the time of making the assessment.

For the purposes of this section there is a change in the constitution of a firm if:

- (a) One or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change (this clause, however, shall not apply to a case where the firm is dissolved on the death of any of its partners) or
- (b) Where all the partners continue with a change in their respective shares or in the shares of some of them.

4.6 LOSSES OF REGISTERED FIRMS (Section 75)

Carry forward and set off of losses in case of change in constitution of firm or on succession [Section 78(1)] Where a change has occurred in the constitution of a firm on account of death or retirement, the

firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

Method of computation of amount not to be allowed to be carried forward

Step 1: In the year of change first ascertain the share of outgoing partner in the profit or loss of the firm.

Step 2: Compute share of loss of the outgoing partner for each of the preceding years from which the loss is carried forward.

Step 3: Amount not allowed to be carried forward: (i) Sum of [Amounts computed in Steps (1) and (2) where there is loss in the year of change]. (ii) Difference of [Amounts computed in Steps (1) and (2) in case of profit in the year of change].

ASSESSMENT OF PARTNERS

As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm will not be included in computing his total income. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.

Further, the explanation to Sub-clause (2A) provides that the share of a partner in the total income of the firm assessed as a firm shall be an amount which bears to the total income of the firm the same proportion as the amount of his share in the profits of the firm (in accordance with the partnership deed) bears to such profits.

In terms of a formula, the amount exempt would be:

Partners share in the profit of the firm =

As shown in the partnership deed

_____ Total income of the firm

Total Profits of the firm

Any interest, salary, bonus, commission or remuneration by whatever name called which is due to or received by a partner of a firm from the firm will be chargeable to tax in the hands of the partner under the head “profits and gains of business or profession”. However, if such salary, interest, bonus, commission or remuneration (or any part thereof) has not been allowed as deduction as per Section

40(b) in the hands of the firm, the amount not allowed as deduction shall not be charged to tax in the hands of partners.

Further, deductions under Sections 32 to 37 can be claimed by a partner from any income where any expenditure was incurred to earn such income.

4.7 SUCCESSION OF ONE FIRM BY ANOTHER FIRM (Section 188)

When all the partners in the predecessor firm are replaced by new partners in the successor firm, it is known as succession of one firm by another firm. If a firm is dissolved and some of the partners take over the firm's business or carry on a similar business with or without new partners, it would be a case of succession by a new firm (62 I.T.R. 75).

In CIT v. K.H. Chambers (1965) 55 ITR 674, the Supreme Court laid down the following requisites of succession:

- (i) There is a change of ownership.
- (ii) The whole business is transferred.
- (iii) Substantially the identity and the continuity of the business are preserved.

Where the partnership deed does not provide specifically for continuance of the firm on the death of a partner, there would be no change in constitution of the firm but it would be a case of succession. [*Addl. CIT v. Thyagasundaramudaliar*(1981) 127 ITR 520].

Where a firm is succeeded by another firm, separate assessments are made on the predecessor and successor firms respectively in accordance with the provisions of Section 170 which provides that the predecessor shall be assessed in respect of the income of the previous year in which the succession took place up to the date of succession and the successor shall be assessed in respect of the income of the previous year after the date of succession. If the predecessor cannot be found, or the tax assessed on the predecessor cannot be recovered from him for the previous year (in which the succession took place) and the previous year immediately preceding such previous year, the unrealised tax payable by the predecessor shall be recovered from the successor.

However, the successor firm is entitled to recover from the predecessor firm any tax paid by it on behalf of the former. If any tax is due against any partner of the predecessor firm, it cannot be recovered from the successor firm.

Joint and several liability of partners for tax payable by firm (Section 188A)

As per this section every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of Income-tax Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

Firm Dissolved or Business Discontinued (Section 189)

Where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the assessment of the total income of the firm shall be made as if no such discontinuance or dissolution had taken place and all the provisions of the Act, including the provisions relating to penalty or any other sum (interest, fine) chargeable under the Act, shall apply. Consequently, every person who was a partner of the firm at the time of discontinuance of business or dissolution of the firm and legal representative of the deceased partner shall be jointly and severally liable to the amount of tax penalty and any other sum. Where the dissolution or discontinuance of business takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the partners or legal representative of a deceased partner from the stage at which the proceedings stood at the time of such dissolution or discontinuance.

Thus, every partner of the firm and the legal representative of the deceased partner is liable to pay the tax which is already due or may have become due after the dissolution, irrespective of his interest in the firm. However, if there was any irrecoverable amount at the time of dissolution or discontinuance of business and later on it was recovered by the partners, the partners shall personally pay the tax on their share so recovered.

4.8 COMPUTATION OF INCOME ON ESTIMATED BASIS IN CASE TAX PAYERS ARE ENGAGED IN CERTAIN BUSINESS (Section 44AD)

An assessee being an individual, a resident HUF or a partnership firm (not being a LLP), who has not claimed any deduction under Sections 10A, 10AA, 10B, 10BA, 80HH to 80 RRB in the relevant assessment year is eligible to pay tax on estimated basis.

Further, the assessee should be engaged in any business (whether it is retail trading or wholesale trading or civil construction or any other business). The turnover/gross receipt of the eligible business should not exceed `1 crore during the previous year.

The following persons are not eligible to avail benefit under Section 44AD:

(a) a person carrying on profession as referred to in Section 44AA(1) or

(b) a person earning income in the nature of commission or brokerage or

(c) a person carrying on any agency business or

(d) a person who is in the business of plying, hiring or leasing goods carriages.

If the above conditions are satisfied, the income from eligible business is estimated @ 8% of gross receipt or total turnover. Further, it is assumed that all the deductions have been allowed and no other deduction is allowed.

However, in case of firm, the normal deduction in respect of salary and interest to partners under Section 40(b) shall be allowed.

4.9 OTHER PROVISIONS RELATING TO LIMITED LIABILITY PARTNERSHIP:

(1) Transfer of capital asset or intangible asset by a private Limited company or a non-listed company to Limited Liability Partnership and correspondingly any transfer of a share or shares held in a company by a shareholder shall not be treated as transfer:

Any transfer of a capital asset or intangible asset by a private company or unlisted public company (hereafter in this clause referred to as the company) to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership in accordance with the provisions of section 56 or section 57 of the Limited Liability Partnership Act, 2008 shall not be treated as transfer for the purpose of capital gain under section 45 subject to the following conditions:

(a) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;

(b) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion;

(c) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership;

(d) the aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion;

(e) the total sales, turnover or gross receipts in the business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees; and

(f) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

(2) Consequential amendments due to conversion of a private limited company or a non-listed company into LLP:

(i) Allowability of depreciation: Aggregate deduction, in respect of depreciation of buildings, machinery, plant or furniture, being tangible assets or know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets allowable to the predecessor and the successor in the case of succession of company into LLP, shall not exceed in any previous year the deduction calculated at the prescribed rates as if the succession, had not taken place.

(ii) Successor LLP will be allowed deduction of payment under Voluntary Retirement Scheme for the unexpired period: Where a private company or unlisted public company is succeeded by a

limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiiib) of section 47, the provisions of this section shall, as far as may be, apply to the successor limited liability partnership, as they would have applied to the said company, if reorganisation of business had not taken place.]

(iii) Cost of Acquisition of the asset in case the predecessor company has claimed deduction under section 35AD shall be taken to be nil in the hands of LLP.

(iv) Actual cost of the block of the asset in the hand of successor LLP: Where in any previous year, any block of assets is transferred by a private company or unlisted public company to a limited liability partnership and the conditions specified in the proviso to clause (xiiiib) of section 47 are satisfied, then, notwithstanding anything contained in clause (1), the actual cost of the block of assets in the case of the limited liability partnership shall be the written down value of the block of assets as in the case of the said company on the date of conversion of the company into the limited liability partnership.

(v) Carry Forward and set off of losses (Section 72A(6A): Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

However, if any of the conditions laid down in the proviso to clause (xiiiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

“Accumulated loss” means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation

business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

“Unabsorbed depreciation” means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

(vi) MAT credit of the predecessor company will lapse.

4.10 ALTERNATE MINIMUM TAX (AMT) (Section 115JC)

Where the regular income tax payable for a previous year by a person other than a company is less than the alternate minimum tax payable for such previous year then the adjusted total income shall be deemed to be the total income of that person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus education & SHEC @ 3%.

Upto Assessment Year 2012-13, Alternate Minimum Tax (AMT) is levied on limited liability partnerships (LLPs). However, no such tax is levied on the other form of business organisations such as partnership firms, sole proprietorship, association of persons, etc.

In order to widen the tax base vis-à-vis profit linked deductions, the provisions regarding AMT has been broadened to cover all persons other than a company, who has claimed deduction under any section (other than section 80P) included in Chapter VI-A under the heading “C – Deductions in respect of certain incomes” or under section 10AA, shall be liable to pay AMT.

Accordingly, where the regular income-tax payable for a previous year by a person (other than a company) is less than the alternate minimum tax payable for such previous year, the adjusted total income shall be deemed to be the total income of such person and he shall be liable to pay income-tax on such total income at the rate of eighteen and one-half per cent.

For the purpose of the above,

(i) “adjusted total income” shall be the total income before giving effect to provisions of Chapter XII-BA as increased by the deductions claimed under any section (other than section 80P) included in Chapter VI-A under the heading “C – Deductions in respect of certain incomes” and deduction claimed under section 10AA;

(ii) “alternate minimum tax:” shall be the amount of tax computed on adjusted total income at a rate of eighteen and one half per cent; and

(iii) “regular income-tax” shall be the income-tax payable for a previous year by a person other than a company on his total income in accordance with the provisions of the Act other than the provisions of Chapter XII-BA.

It is further provided that the provisions of AMT under Chapter XII-BA shall not apply to an individual or a Hindu undivided family or an association of persons or a body of individuals (whether incorporated or not) or an artificial juridical person referred to in section 2(31)(vii) if the adjusted total income of such person does not exceed twenty lakh rupees.

It is also provided that the credit for tax (tax credit) paid by a person on account of AMT under Chapter XII-BA shall be allowed to the extent of the excess of the AMT paid over the regular income-tax. This tax credit shall be allowed to be carried forward up to the tenth assessment year immediately succeeding the assessment year for which such credit becomes allowable. It shall be allowed to be set off for an assessment year in which the regular income-tax exceeds the AMT to the extent of the excess of the regular income-tax over the AMT.

Every person to which this section applies shall obtain a report, in such form as may be prescribed from an accountant certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report on or before the due date of filing of return under sub-section (1) of section 139.

PROBLEMS

A) PARTNERSHIP FIRM/LLP ASSESSED U/S 184.

ILLUSTRATION I

A and B are active partners and C and D are sleeping partners in a firm. A profit and loss account, drawn for the year ending 31-3-2021 shows a profit of rs. 25000. The Profit has been arrived at after allowing salary and interest to partners as follows:

| A | B | C | D | |
|---------------|---|-------|-------|------|
| Salary | | 25000 | 23000 | — |
| Interest @ 9% | | 2000 | 4000 | 6000 |

Further the long term capital gains of the firm are Rs. 40000. Partners share the profit and loss equally. Compute the total income of the firm and its tax liability. Interest to all the partners and salary to working partners has been paid as per deed.

SOLUTION:

Rs.Rs.

Net profit as per profit and loss A/C 25000

Add: Disallowed deductions:

Salary to partners

A 25000

B 23000

Interest to partners is less than 12% & hence allowed 48000

Book Profit 73000

Less: allowable remuneration to partner's u/s 40(b)

Since salary etc. given to all partners is less than

Rs. 150000 hence allowed in full 48000

Business profit 25000

Capital gain:

Long term capital gain 40000

G.T.I & Total Income **65000**

Tax liability of the firm

On long term capital gain of Rs 40000 @ 20% 8000

On balance income (65000-40000 = 25000) @30% 7500

Tax 15,500

Add: Education cess @ 4% of tax
Tax Payable

620
 16120

ILLUSTRATION II

Profit and Loss Account of ABC and Co. (a firm of chartered accountants) for the year ending 31-3-2021 is as follows:

| | Rs. | | Rs. |
|---------------------------------------|--------|-----------------------|--------|
| Expenses | 10000 | Receipts from clients | 135000 |
| Depreciation | 75000 | Bank interest | 25000 |
| Remuneration to working partners | 80000 | Net Loss | 42500 |
| Interest on capital to partners @ 20% | 37500 | | |
| | 202500 | | 202500 |

Other information:

i) Out of expenses of Rs. 10000, Rs. 6400 is not deductible by virtue of section 36 and 37.

ii) Depreciation as per section 32 is Rs. 27500.

Find out the amount of net income of the firm for the assessment year 2021-22. The remuneration and interest on capital to partners have been paid according to partnership deed which has been submitted along with return.

SOLUTION:

| Computation of Firms Total Income | Rs. | Rs. |
|--|--------------|--------------|
| Professional receipts | | 135000 |
| Less: Professional expenses | | |
| Allowable Expenses (10000-6400) | 3600 | |
| Allowable depreciation | 27500 | |
| Interest on capital (37500x 12/20) | <u>22500</u> | <u>53600</u> |
| Book Profit | 81400 | |
| Less: Allowable remuneration u/s 40(b) | | |
| Actual Remuneration | 80000 | |
| Or | | |
| 90% of Book Profit of Rs. 81400 | 73260 | |
| Whichever is more is allowed | | <u>80000</u> |
| Taxable Business profit | | 1400 |

Add: Income from other sources

| | |
|---------------------------|--------------|
| Bank Interest | 25000 |
| Firms total Income | 26400 |

ILLUSTRATION III

The doctors Dr. Ahalya and Somnathare running a nursing home under a partnership firm profits and losses equally and showed Rs. 16600 as profit for the previous year 2021-22 after charging the following:

| | |
|--|-------|
| <i>Operation charges to Dr. Somnath(100 per operation)</i> | 1500 |
| <i>Remuneration to Dr. Ahalya</i> | 6200 |
| <i>Honorarium to Dr. Somnath</i> | 3000 |
| <i>Bonus to Each Doctor</i> | 2000 |
| <i>Donation to shelter for Hindus</i> | 3750 |
| <i>Interest on Capital to each Doctor@9%</i> | 2000 |
| <i>Purchase of surgical equipment</i> | 12500 |
| <i>House property rent</i> | 9600 |
| <i>Bank Interest</i> | 4000 |

Compute firms' total income and find out the income of partners taxable under the head profit and gains. Firm's deed provides for payment of operation charges, remuneration, bonus, honorarium and interest on capital.

SOLUTION

| Computation of Firms Professional Gain | RsRs | |
|---|-------------|-------|
| Net profit as per P&L A/C | | 16600 |
| Add: <i>Disallowed expenses</i> | | |
| Operation charges to Dr. Somnath | 1500 | |
| Remuneration to Dr. Ahalya | 6200 | |
| Honorarium to Dr. Somnath | 3000 | |
| Bonus to each doctor | 4000 | |
| Donation to shelter for Hindus | 3750 | |
| Cost of surgical equipment | 12500 | 30950 |
| 47550 | | |
| Less: <i>Allowable expenses</i> | | |

| | | |
|----------------------------|--|-------|
| Depreciation (12500 @ 15%) | | 1875 |
| | | 45675 |

Less: Income not taxable under this head

| | | |
|--------------------------|------|-------|
| Rent from House property | 9600 | |
| Bank interest | 4000 | 13600 |

Book Profit 32075

Less: Allowable remuneration/s 40(b)

| | | |
|----------------------------------|-------|-------|
| Operation charges to Dr. Somnath | 1500 | |
| Honorarium to Dr. Somnath | 3000 | |
| Remuneration to Dr. Ahalya | 6200 | |
| Bonus to each Doctor(2000) | 4000 | 14700 |
| Professional gain | 17375 | 17375 |

Computation of Firms Total Income

| | | |
|--------------------------------------|------|-------|
| House Property: ARV | 9600 | |
| Less: M.Taxes | Nil | |
| N.A.V | 9600 | |
| Standard deduction: 30% of NAV | 2880 | 6270 |
| Profits and Gains: Professional gain | | 17375 |
| Other sources: Bank interest | | 4000 |
| Total Income | | 28095 |

Rounded off to Rs. 28100

Firms Tax: 30% of 28100=Rs. 8430 + Edu. cess@3 % i.e. Rs.253= Rs 8683, rounded off to 8680

Partners Professional Income

| | | | |
|----------------|---------------------|------|-------|
| 1. Dr Ahalya: | Remuneration | | 6200 |
| | Bonus | 2000 | |
| | Interest on Capital | 2000 | 10200 |
| 2. Dr Somnath: | Operation Charges | | 1500 |
| | Honorarium | | 3000 |
| | Interest on Capital | | 2000 |

Bonus

2000

8500

Notes: 1. share of income from Firm is fully exempted u/s 10(2A) in the hands of partners.

2. Operating charges, remuneration, honorarium and bonus paid to partners are fully allowed as they are within limits.

B) ASSESSMENT OF FIRM/LLP U/S 185.

ILLUSTRATION I

Asim, John and Rahim are partners in a firm assessed as u/s 185 sharing profits and losses in the ratio of 5:3:2. Profit and loss account for the year ending on 31-3-2017 was as follows:

| <i>Profit & Loss</i> | | | |
|-------------------------------|--------------|---------------------------|--------------|
| To rent and taxes | 6000 | By Gross Profit | 40000 |
| To salaries | 9000 | By Interest on securities | 3000 |
| To electric charges | 1200 | | |
| To interest on capital | | | |
| Asim | 2000 | | |
| John | 1500 | | |
| Rahim | 1000 | | |
| To Depreciation | 2500 | | |
| To Reserve for bad debts | 500 | | |
| To interest on loan from John | 300 | | |
| To commission to Rahim | 1000 | | |
| To Balance: | | | |
| Asim | 9000 | | |
| John | 5400 | | |
| Rahim | 3600 | | |
| | <u>43000</u> | | <u>43000</u> |

Note: 1. Salary includes Rs. 2000 paid to Rahim

2. Depreciation allowable amount to Rs. 2400

Compute the Business Income for Firm as AOP and U/s 185.

SOLUTION

Computation of business income of the firm assessed u/s 185

RsRs

| | | |
|---|------|---------------------|
| Profit as per P/L A/c | | 18000 |
| Add: expenses charged but not allowed: | | |
| Interest on capital | | |
| Asim | 2000 | |
| John | 1500 | |
| Rahim | 1000 | 4500 |
| | | <u>22500</u> |
| Depreciation | 2500 | |
| Reserve for Bad debts | 500 | |
| Interest on loan from John | 300 | |
| Commission to Rahim | 1000 | |
| Salary to Rahim | 2000 | 6300 |
| | | <u>28800</u> |
| Less: Income credited but to be treated under a separate head: | | |
| Income from other sources: Interest on Securities | | 3000 |
| | | <u>25800</u> |
| Less: Allowable business expenses | | |
| Depreciation | | 2400 |
| Business Income of Firm | | <u>23400</u> |

ILLUSTRATION II

PQR and Co. A partnership firm with three partners P, Q and R sharing profits and losses in the ratio of 3:2:1, gives the following particulars of its profit and loss account for the year ending on 31st March 2021:

- Profit as per profit and loss account, Rs 50000
- Drawings debited to profit and loss account Rs. 40000
- Depreciation debited 75000. actually admissible 90000.
- Entertainment expenses 10000

e) Bad debts recovered and credited to P/L A/c-15000.This is recovery out of a debt of 40000 written off as bad in 2019-20 of which only Rs 30000 was allowed in the relevant assessment.

f) Salaries paid to Q. Rs 12000

g) Commission paid to R. Rs 20000

Compute the total income of the firm as u/s 18. Each item of information above should be fully dealt with in your answer.

SOLUTION

Computation of Firms Total Income assessed u/s 185

RsRs

Profit as per P/L A/c 50000

Add: Disallowed items

| | | |
|-----------------|-------|---------------|
| Drawings | 40000 | |
| Depreciation | 75000 | |
| Salaries to Q | 12000 | |
| Commission to R | 20000 | 147000 |
| | | <u>197000</u> |

Less: Incomes not taxable under the head

| | | |
|---|-------|---------------|
| Bad debts recovered----Disallowed earlier (40000-30000=10000) being exempted | 10000 | |
| | | <u>187000</u> |

Less: Expenses allowed but not debited

| | | |
|---------------------------|--|---------------------|
| Depreciation 90000 | | |
| Firms Total Income | | <u>97000</u> |

4.11 ASSOCIATION OF PERSONS

‘Association of persons’ has not been defined in the Income-tax Act. However in the case of CIT v. Indira Balkrishna [(1960) 39 ITR 546] the Supreme Court has defined it as:

“Association of persons” means an association in which two or more persons join in for a common purpose or common action to produce income, profits or gains”.

An association of persons may consist of non-individuals (Companies, firms joint families) [Ipoth v. CIT (1968) 67 ITR 106 (S.C.)]. A minor can join an AOP if his lawful guardian gives his consent. [Murugesan& Bros. v. CIT (1973) 88 ITR 432 (SC)].

Applying the ratio laid down by the Supreme Court in the case of G. Murugesan and Bros. v. Commissioner of Income-tax (1973, 88 ITR 432), the Kerala High Court held in the case of Commissioner of Income-tax v. Goel C. Dalal and Perin C. Dalal (1990, 184 ITR 248) that in order to acquire the status of an association of persons, the persons must join in a common purpose or action and the object of the association must be to produce income. It is not enough that the persons receive the income jointly.

4.12 FORMATION OF AN ASSOCIATION OF PERSONS

For the formation of an AOP the association need not necessarily be on the basis of a contract, consent and understanding may be presumed [Shanmugham& Co. v. CIT (1971) 81 ITR 310 (S.C.)].

Applying the ratio laid down by the Supreme Court in the case of N.V. Shanmugham& Co. v. Commissioner of Income-tax (1971, 81 ITR 310) the Calcutta High Court held in the case of Gopal Chand Sen v. Income-tax Officer and others (1977, 109 ITR 820) that an assessment of business income has to be done in the hands of receivers and in such an assessment, the receivers are never assessed as independent earners of income. The income in the hands of the receiver is assessable in the like manner and to the same extent as it would have been assessed on the real owners.

However, co-owners, co-heirs or co-legatees do not constitute an AOP in respect of the income of the joint or common asset by reason only of their jural relationship. But if they write themselves with the objective of earning income they constitute an AOP for assessment purposes. [Estate of Mohamed Rowther v. CIT (1963, 49 ITR 39)]. Section 26 of the Income-tax Act provides that where property consisting of building or buildings and lands appurtenant thereto is owned by two or more persons in definite and ascertainable shares, such persons shall not, in respect of such property be assessed as an AOP, but on their respective share of income therefrom.

In order to constitute an association of persons, there must be joining together in a common purpose or in a common action, the object of which is to produce income, profits and gains. Though a body of individuals is not identical with an association of persons, they have some similarities. An association of persons may consist of non-individuals also but a body of individuals has to consist only

of human beings. The word 'body' would require an association for some common purpose or for a common cause or there must be unity under some common tie or occupation. A mere collection of individuals without a common tie or common aid cannot be taken to be a body of individuals failing under Section 2(31) of the Income-tax Act, 1961. [See CIT v. Deghamwala Estates (1980, 121 ITR 684)].

4.13 TAX LIABILITY OF ASSOCIATION OF PERSONS

With effect from assessment year 1989-90, the following provisions are applicable to assesseees other than companies, co-operative societies and societies registered under the Societies Registration Act, 1860 or any law corresponding to that Act in force in any part of India.

(1) Interest paid by the AOP to a member will not be allowed as a deduction from the income of the Association of Persons [Section 40(ba)]. In cases where interest is paid by the AOP to any member, who has also paid interest to the AOP, the net amount of interest that will be disallowed is the amount of interest paid by the AOP to the member less the amount of interest paid to the AOP by the member [Explanation 1 to Section 40(ba)].

(2) In cases where an individual is a member of an AOP in a representative capacity, any interest paid by the AOP to such individual or by such individual to the AOP, otherwise than in a representative capacity will not be subject to disallowance under explanation 2(i) to Section 40(ba).

(3) In the cases of interest paid by AOP to such individual or by such individual to the AOP in a representative capacity any interest paid by the AOP to the person represented by such person or vice versa, will not be allowed under Section 40(ba) [Explanation 2(ii) to Section 40(ba)].

(4) Explanation 3 to Section 40(ba) further provides that where an individual is a member of the AOP otherwise than as member in a representative capacity, any interest paid by the AOP to such individual will not be disallowed if the interest is received by him on behalf of any other person.

(5) Any salary, bonus, commission or remuneration (by whatever name called) paid by the AOP to a member will not be allowed as a deduction.

Section 167B makes the following provisions as regards the incidence of charge of tax on the association of persons.

A. Where shares of members are determinate

In this case, tax is chargeable on the income of the association of persons at the same rate as applicable to an individual. However, where the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate of 30%, i.e. the highest slab applicable to an individual. More so, where the total income of any member of the AOP, irrespective of whether or not it exceeds the maximum amount not chargeable to tax in the case of an individual, is chargeable to tax at a rate higher than the maximum marginal rate, tax will be charged on the total income of the AOP at such higher rate.

B. Where the shares of the members are indeterminate

In these cases, tax will be charged on the total income of the AOP at the maximum marginal rate, that is, the rate of tax as well as surcharge, if any, applicable to the highest slab of income in the case of an individual as specified in the Finance Act of the relevant year. The individual shares of the members in the whole or any part of the income of the AOP will be deemed to be indeterminate or unknown if such shares are indeterminate or unknown on the date of formation of the AOP, or at any time thereafter.

4.14 METHOD OF COMPUTING SHARE OF A MEMBER OF ASSOCIATION OF PERSONS, ETC. (Section 67A)

Section 67A seeks to provide for the method of computing a member's share in the income of an association of persons or a body of individuals, wherein the shares of the members are determinate, in the same manner as provided for in Sub-sections (1) to (3) of Section 67 for computing a partner's share in a firm. This section lays down the following methods of computing the member's share:

(a) Any interest, salary, bonus, commission or remuneration, by whatever name called, paid to any member in respect of the previous year shall be deducted from the total income of the association or body and the balance ascertained and apportioned among the members in the proportion in which they are entitled to share the income of the association or body.

(b) Where the amount apportioned to a member under (a) hereinabove is a profit, any interest, salary, bonus, commission or remuneration paid to the member by the AOP in respect of the previous year shall be added to that amount - the result shall constitute the member's share in the income of the association or body.

(c) Where the amount apportioned to a member under (a) is a loss, any interest, salary, bonus, commission or remuneration aforesaid paid to the member by the association or body in respect of the previous year shall be adjusted against that amount, the result shall be adjusted against that amount, and the result shall be treated as the member's share in the income of the association or body.

See also explanatory notes on the provision of DTL (Amendment) Act, 1987 Board circular No. 551 dated 23.1.1990 [(1990, 183 ITR 1 (SC)].

4.15 TAX ON INCOME OF ASSOCIATION OF PERSONS, ETC. WHICH IS INDETERMINATE OR UNKNOWN (New Section 167B)

Section 167B seeks to provide that where the individual shares of the members of an association or body in the whole or any part of the income of such association or body are indeterminate or unknown, tax shall be charged on the total income of the association or body at the maximum marginal rate. However, where the total income of any member of such association or body is chargeable to tax at a rate which is higher than the maximum marginal rate, tax shall be charged on the total income of the association or body at such higher rate. Also, where the total income of any member of an association of persons or body of individuals as above for the previous year (excluding his share from such association or body) exceeds the maximum amount which is not chargeable to tax in the case of that member, tax shall be charged on the total income of the association or body at the maximum marginal rate. However, where any member or members of such association or body of individuals is or are chargeable to tax for the previous year at a rate or rates which is or are higher than the maximum marginal rate, tax shall be charged on that portion or portions of the total income of the association or body of individuals which is or are relatable to the share or shares of such member or members at such higher rate or rates, as the case may be, and the balance of the total income the association or body shall be taxed at the maximum marginal rate.

In the explanation to the above provisions, it is provided that the shares of the members of an association or body in the whole or any part of the income of such association or body shall be deemed to be indeterminate or unknown if such shares (in relation to the whole or any part of such income) are indeterminate or unknown on the date of formation of such association or body or any time thereafter.

4.16 SHARE OF MEMBER OF ASSOCIATION ETC.(Section 86)

Section 86 relates to shares of members of an association of persons or a body of individuals in the income of the association or body. This section provides that if the assessee is a member of an association of persons or a body of individuals (other than a company or a Co-operative society or a Society registered under the Societies Registration Act, 1860, or any law corresponding to that Act in force in any part of India), his share in the income of the association or body, computed in the manner provided in Section 67A shall not be liable to tax. Further, where the association or body is chargeable to tax on its total income at the maximum marginal rate or any higher rate, under any of the provisions of the Income-tax Act, his share computed in the manner stated above shall not be included in his total income. But, in other cases and in cases where no income-tax is chargeable on the total income of the association or body, the member's share shall be chargeable to tax as part of his total income and Section 86 shall not be applicable to such case.

The charge of tax on the member's share in AOP will depend on the following factors:

- (i) Income-tax is not payable by the member in respect of his share in the income of the AOP, computed in the manner provided in Section 67A.
- (ii) His share in the income of the AOP is includible in his total income for rate purposes.
- (iii) Where the AOP is chargeable to tax on its total income at the 'maximum marginal rate' or at any higher rate, the share of the member will not be includible in his total income. In this case, the member's share in the income of the AOP will not be included in his income even for rate purposes.
- (iv) In any other case, the member's share will form part of his total income.
- (v) Where no income-tax is chargeable on the total income of the AOP, the share of the member will be chargeable to tax part of his total income. Section 86 will not be applicable to such cases.

Assessment in case of Dissolution of an Association of Persons (Section 177) Where any business or profession carried on by an AOP has been discontinued or an AOP is dissolved, the Assessing Officer shall make an assessment of the total income of the AOP as if no such discontinuance or dissolution had taken place, and all provisions of this Act, including the provisions relating to the levy of penalty or any other sum chargeable under any provisions of the Income-tax Act shall apply.

Every person who was at the time of such discontinuance or dissolution a member of the AOP and the legal representative of any such person who is deceased, shall jointly and severally be liable for the amount of tax, penalty or other sum payable.

Where such discontinuance or dissolution takes place after any proceeding in respect of an assessment year have commenced, the proceedings may be continued against the members from the stage at which the proceedings stood at the time of such discontinuance or dissolution.

4.17 SUMMARY

Assessment is a procedure used by government assessors to determine the value of a property, or the income of a person or entity, in order to charge taxes or to levy on the orders of a court. In other words it is a value calculated as the basis for determining the amounts to be paid or assessed for tax or insurance purposes. A tax assessor is responsible for preparing and maintaining the assessment roll, the tax roll and collecting the tax levies in accordance with the quality standards.

Under Section 2(23) of the Income-tax Act, the terms “firm”, “partner”, and “partnership” have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

The expression “partner” also includes a minor who has been admitted to the benefits of partnership and a partner of a Limited Liability Partnership Act 2008. However a minor cannot validly enter into any partnership as a ‘full partner’ with other persons but he can be admitted to the benefits of partnership only.

A joint Hindu family as such cannot be a partner in a firm. However, through its Karta it may enter into a valid partnership with a third person or with a member of the undivided family in his individual capacity. In such a case, the Karta occupies a dual position. On the partnership he functions in his individual capacity; on the relations to other members of the Hindu undivided family, in his representative capacity.

An incorporated company being a legal person may form a partnership with an individual or with another company. In considering the maximum number of partners comprising a firm, the company will be considered as one person only.

“Association of persons” means an association in which two or more persons join in for a common purpose or common action to produce income, profits or gains”. An association of persons may consist of non-individuals (Companies, firms joint families) [Ipoth v. CIT (1968) 67 ITR 106 (S.C.)]. A minor can join an AOP if his lawful guardian gives his consent. [Murugesan& Bros. v. CIT (1973) 88 ITR 432 (SC)]. Applying the ratio laid down by the Supreme Court in the case of G. Murugesan and Bros. v. Commissioner of Income-tax (1973, 88 ITR 432), the Kerala High Court held in the case of Commissioner of Income-tax v. Goel C. Dalal and Perin C. Dalal (1990, 184 ITR 248) that in order to acquire the status of an association of persons, the persons must join in a common purpose or action and the object of the association must be to produce income. It is not enough that the persons receive the income jointly.

Section 67A seeks to provide for the method of computing a member’s share in the income of an association of persons or a body of individuals, wherein the shares of the members are determinate, in the same manner as provided for in Sub-sections (1) to (3) of Section 67 for computing a partner’s share in a firm. This section lays down the following methods of computing the member’s share:

- (a) Any interest, salary, bonus, commission or remuneration, by whatever name called, paid to any member in respect of the previous year shall be deducted from the total income of the association or body and the balance ascertained and apportioned among the members in the proportion in which they are entitled to share the income of the association or body.
- (b) Where the amount apportioned to a member under (a) hereinabove is a profit, any interest, salary, bonus, commission or remuneration paid to the member by the AOP in respect of the previous year shall be added to that amount - the result shall constitute the member’s share in the income of the association or body.
- (c) Where the amount apportioned to a member under (a) is a loss, any interest, salary, bonus, commission or remuneration aforesaid paid to the member by the association or body in respect of the previous year shall be adjusted against that amount, the result shall be adjusted against that amount, and the result shall be treated as the member’s share in the income of the association or body.

PROBLEMS

ILLUSTRATION I:

The total income of a AOP in which A, B & C are members share profits and losses in the ratio of 1:2:2 was assessed at Rs. 16000. In computing the total income of Rs. 16000 the Income Tax Officer has made the necessary adjustments in respect of the following sums:

Salaries of Rs. 12000 and 8000 to A and B respectively.

Interest of Rs. 1000, Rs. 6000 and 25000 to A, B and C respectively.

Commission of Rs. 2000, 5000 and Rs. 7000 to A, B and C respectively.

C has borrowed capital for his investment in the firm and had paid interest of Rs. 15000 separately to the lender. Compute the share of the respective partners for their individual assessment.

Solution:

Allocation of Firms income amongst members

| | A | | B |
|---|--------|--------|--------|
| C | | | |
| Income | | | |
| Salary | 12000 | 8000 | Nil |
| Interest | 1000 | 6000 | 25000 |
| Commission | 2000 | 5000 | 7000 |
| Total | 15000 | 19000 | 32000 |
| Share of Income [16000-(15000+19000=32000)] | -10000 | -20000 | 20000 |
| Net share | +5000 | +1000 | +12000 |
| Interest on loan taken by C | | | 15000 |
| Balance Share | | | 3000 |

B and C cannot adjust their share of loss from their individual income. A's share shall be added in his individual income.

ILLUSTRATION II

Arun and Barun were members of an AOP whose accounting year ends on 31st March every year. On 1st April 2020 Shanti (Barun's wife) joined the firm as a member and there after all the three members are entitled to share profits and losses equally. Shanti invested a sum of Rs. 200000 as

her capital in the firm, the source of such investment being the gift received from her father. The other two members have no capital in the firm. Shanti is actively engaged in the business.

For the assessment year 2021-22, the firms total income has been determined by the income tax officer at Rs. 45000 after making due adjustments in respect of the following items:

1) *Salary:*

| | | |
|---------------|--------------|--------------|
| <i>Arun</i> | <i>15000</i> | |
| <i>Barun</i> | <i>10000</i> | |
| <i>Shanti</i> | <i>10000</i> | <i>35000</i> |

2) *Interest on Capital*

| | | |
|---------------|--|--------------|
| <i>Shanti</i> | | <i>28000</i> |
|---------------|--|--------------|

3) *Brokerage:*

| | | |
|---------------|--------------|--------------|
| <i>Arun</i> | <i>12000</i> | |
| <i>Shanti</i> | <i>12000</i> | <i>24000</i> |

4) *Rent*

| | | |
|--|--|-------------|
| <i>Barun(for the office premises owned by him)</i> | | <i>9000</i> |
|--|--|-------------|

Arun won a prize of Rs. 10000 in west Bengal State Lottery and a sum of Rs. 3000 was deducted at source out of the same. Shanti holds 10000 equity shares of a company in which a dividend of 95 paise per share was declared by the company in its Annual General Meeting held on 28 March 2017. Apart from the above, no partner has any other income whatsoever.

SOLUTION:

Allocation of Firms income against partners

| | Arun | Barun | Shanti |
|---------------|-------------|--------------|---------------|
| Income | | | |
| Salary | 15000 | 10000 | 10000 |

| | | | |
|---|--------|--------|--------|
| Interest | | | 28000 |
| Brokerage | 12000 | Nil | 12000 |
| Total | 27000 | 10000 | 50000 |
| Share of Income | | | |
| [45000-(27000+10000+50000)]=42000 Ratio equal-14000 | | -14000 | -14000 |
| Net Share | +13000 | -4000 | +36000 |

Individual Income of members:

| | | | |
|--|-------|--------|-------|
| <i>House Property: For Barun[rent 9000 less 30%]</i> | Nil | 6300 | Nil |
| <i>Profits and gains: Share from AOP</i> | 13000 | Nil | 36000 |
| <i>Income from other sources:</i> | | | |
| <i>Lottery prize for Arun</i> | 10000 | Nil | Nil |
| <i>Dividend from Indian Co. for Shanti-exempted</i> | Nil | NilNil | |
| <i>Total income of each member</i> | 23000 | 6300 | 36000 |

Barun cannot setoff his share of loss from AOP out of his individual Income

ILLUSTRATION III

Mr. K, Mrs. L and Mr. M are members of an AOP sharing profits and losses equally. During the year ending 31-2-2021 total income of AOP was 2,94,000. The details of individual income of its members are given below:

Mr. K

| | |
|--|--------|
| Rent from house property: | 60,000 |
| Interest on deposits with HUDCO | 36,000 |
| Bank interest | 50,000 |
| Short-term capital gain on sale of jewelry | 40,000 |

Mrs. L

| | |
|---------------------------------------|--------|
| House property income (computed) | 80,000 |
| Bank interest on fixed deposits: | 30,000 |
| Interest on post office fixed deposit | 12,000 |

| | |
|------------------------------------|----------|
| Interest on debentures (gross) | 96,000 |
| Mr. M | |
| Pension from Govt. | 1,96,000 |
| Interest accrued on NSC VIII issue | 12,600 |
| Interest on Govt. securities | 15,000 |

Compute tax liability of AOP and its members.

SOLUTION

Computation of tax liability of AOP

AOP shall pay tax at the rates applicable to an individual as total income of each (or all) of its members without adding share from AOP as calculated below does not exceed the exempted limit.

| | | |
|---------------------------------|-------------|-------------------|
| Tax on 29,4,000 Rs. | Rs. | |
| On 2,50,000 | Nil | |
| Tax on balance Rs. 44,000@ 5% | | 2200 |
| Add: Education Cess @ 3% of tax | | <u>66</u> |
| Total tax payable | 2266 | <u> </u> |

Tax payable rounded off to Rs. 2270

Computation of total income and tax liability of members of AOP

Mr. K

| | | | |
|--|------------------------|---------------|-----------------|
| Income from house property: ARV | | 60,000 | |
| Less: Municipal tax | Nil | | |
| Annual Value | 60,000 | | |
| | Standard Deduction 30% | <u>18,000</u> | |
| Income | | | 42,000 |
| Capital gain: Short term capital gain on sale of jewellery | | | 40,000 |
| Income from other sources: Interest on deposits (HUDCO) | | 36,000 | |
| Bank Interest | 50,000 | 86,000 | |
| Gross Total Income | | | <u>1,68,000</u> |
| Deduction u/s 80C to 80U: | | | <u>Nil</u> |
| Total Income | | 1,68,000 | |
| Add: 1/3 rd share from AOP: 1/3 of 2,94,000 | | | <u>98,000</u> |

2,66,000

Tax Liability:

| | |
|----------------------|------------|
| On 2,50,000: | Nil |
| On 16,000@ 5% | <u>800</u> |
| Tax | 800 |
| Less: Rebate u/s 87A | <u>800</u> |
| Tax Payable | <u>Nil</u> |

Mrs. L

| | |
|--|------------------------|
| House property income (computed) | 80,000 |
| Income from other sources: Bank Interest | 30,000 |
| Interest on post office deposits | 12,000 |
| Interest on debentures | <u>96,000</u> |
| Gross Total Income | 2,18,000 |
| Deduction u/s 80C to 80U | Nil |
| Total Income | <u>2,18,000</u> |
| Add: 1/3 rd share from AOP | <u>98,000</u> |
| | <u>3,16,000</u> |

Tax Liability:

| | |
|------------------------------------|-------------|
| On Rs. 250000 | Nil |
| On balance Rs. 66000 @ 5% | <u>3300</u> |
| Tax | 3300 |
| Less: Rebate u/s 87A | <u>2000</u> |
| Tax | 1300 |
| Add: Surcharge @ 3% | <u>39</u> |
| | 1339 |
| Less rebate u/s 86 at average rate | 415 |
| [1339X100/316000=] | <u>924</u> |
| Tax payable | <u>924</u> |
| Tax payable rounded off Rs. 920 | |

Mr. M

| | | |
|--|--------------|------------------------|
| Income from salary: Govt Pension | | 1,96,000 |
| Income from other sources: Intrest accrued (NSC) | 12600 | |
| Interest (Govt. securities) | <u>15000</u> | <u>27,600</u> |
| Gross Total Income | | 2,23,600 |
| Deduction u/s 80C: Interest acc. on NSC | | <u>12,600</u> |
| Total Income | | 2,11,000 |
| Add: 1/3 rd share from AOP | | <u>98000</u> |
| | | <u>3,09,000</u> |
| Tax Liability: | | |
| On 2,50,000 | Nil | |
| On Balance Rs.59000 @ 5% | <u>2950</u> | |
| Tax | 2950 | |
| Less: Rebate u/s 87A | <u>2000</u> | |
| 950 | | |
| Add: Education cess @3% | <u>28.50</u> | |
| Total Tax | | 978.5 |
| Less: rebate u/s 86A at average rate: | | |
| [978.5 x 100/390000=0.32% of Rs. 98000] | | <u>313.6</u> |
| Tax Payable | 664.9 | <u> </u> |
| Tax payable rounded off 660 | | <u> </u> |

4.18 GLOSSARY

- **Partnership Firm:** Under Section 2(23) of the Income-tax Act, the terms “firm”, “partner”, and “partnership” have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

- As per the scheme, a partnership firm shall be assessed as a firm if the following conditions are satisfied:
 - The partnership is evidenced by an instrument i.e. partnership deed.
 - The individual shares of the partners are specified in that instrument.
 - A copy of the partnership deed certified by all the partners in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.
- As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm will not be included in computing his total income. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.
- When all the partners in the predecessor firm are replaced by new partners in the successor firm, it is known as succession of one firm by another firm. If a firm is dissolved and some of the partners take over the firm's business or carry on a similar business with or without new partners, it would be a case of succession by a new firm.
- Where a change has occurred in the constitution of a firm on account of death or retirement, the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.
- Alternate Minimum Tax: From the assessment year 2012-13 onwards, where the regular income tax payable for a previous year by a person other than a company is less than the alternate minimum tax payable for such previous year then the adjusted total income shall be deemed to be the total income of such person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus education & SHEC @ 3%.
- Association of persons: "Association of persons" means an association in which two or more persons join in a common purpose or common action to produce income, profits or gains.
- For the formation of an AOP the association need not necessarily be on the basis of a contract, consent and understanding may be presumed.
- Section 167B makes the following provisions as regards the incidence of charge of tax on the association of persons.

- Where shares of members are determinate In this case, tax is chargeable on the income of the association of persons at the same rate as applicable to an individual. However, where the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate of 30%, i.e. the highest slab applicable to an individual.
- Where the shares of the members are indeterminate In these cases, tax will be charged on the total income of the AOP at the maximum marginal rate, that is, the rate of tax as well as surcharge, if any, applicable to the highest slab of income in the case of an individual as specified in the Finance Act of the relevant year
- Section 67A seeks to provide for the method of computing a member's share in the income of an association of persons or a body of individuals, wherein the shares of the members are determinate, in the same manner as provided for in Sub-sections (1) to (3) of Section 67 for computing a partner's share in a firm.

4.19 SELF ASSESSMENT QUESTIONS

1. What do you mean by Firm?

2. What is the New Scheme of Taxation of a firm?

3. Explain in brief the condition for allowability of deduction of interest to a partner?

4. Explain the difference between the change in constitution and succession of a firm. Illustrate.

5. What is meant by Association of Persons? How is it formed?

6. Discuss tax liability of an Association of Persons?

7. Discuss tax liability of the members of Association of Persons. State the circumstances, if any, under which their share of income from an association of persons is not chargeable to tax?

8. Explain Alternate Minimum Tax (AMT)?

9. Explain Scheme of taxation of a firm and its partners?

4.20 BOOKS RECOMMENDED

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. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; SahityaBhavan Publications.
4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.
5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.
6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.
7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

