

INCOME TAX

BLOCK I — CONCEPTS

BLOCK II — EXEMPTIONS

BLOCK III — HEADS OF INCOME

DR. B.R. AMBEDKAR OPEN UNIVERSITY

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This text forms part of the Open University Course. The complete syllabus for the course appears at the end of this book.

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PREFACE :

This book deals with the topics in Income-tax included in the syllabus for the third year of the B.Com., course offered by the Dr. B.R.Ambedkar Open University. These topics generally cover the 'core' area of the subject to be studied in the Third year of the Three Year Degree Course in Commerce (B.Com.). The syllabus for the sake of convenience is divided into blocks, each of which comprises a number of units. Each unit generally covers a specific area of the subject. The units are prepared by specialist in accordance with a format so designed as to enable the student to read and understand them without much difficulty. Each unit begins with a statement of its objectives followed by a synopsis and has at its end assignment intended to test the student's comprehension of its subject matter.

This material has been updated keeping in view the provision of the Finance Act, 1992. The study of this material would be useful both for the students and the professionals. The illustrations have been explained in a lucid way with necessary notes wherever necessary. In the light of the practical importance of the knowledge of Income-Tax to the students of commerce, Income-Tax is offered as one of the optional course of B.Com. third year programme.

The course material of Income-tax consists of 6 Blocks, which have been divided into 26 units. The first block deals with the concepts of Income-tax. The second block covers exemptions. Block III discusses the various Heads of Income. Block IV deals with Aggregation and Deductions from Income. Block V presents computation of Total Income and tax. Block VI covers Income tax Authorities and Assessment procedure.

The University hopes that this material will help the student to get acquainted with the principal issues in income-tax which make for its distinctiveness and significance.

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BLOCK - I

CONCEPTS

**This block deals with the concepts relating to Income-tax. Five units are included in this block.
They are :**

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|-----------------|----------|----------------------------|
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| Unit - 2 | : | Definitions |
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| Unit - 4 | : | Residential Status |
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UNIT-I: INTRODUCTION

Contents

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- 1.8 Points to be noted in the Study of Income-Tax
- 1.9 Summing-Up
- 1.10 Check Your Progress: Model Answers
- 1.11 Model Examination Questions
- 1.12 Suggested Readings

1.0 AIMS AND OBJECTIVES

The aim of this unit is to familiarise you with the introductory material on the Income-Tax law which you would be studying during the course of the year. It is intended to create interest in the subject through this unit.

After reading this unit, you should be able to:

- give a brief historical account of the Income-Tax Law in India
- explain Income-Tax Rules, 1962
- describe the Scheme of Income-Tax
- explain the importance of the Finance Act.

1.1 INTRODUCTION

As citizens we look to the Government for protection, education, good roads, law and order, good sanitary condition in the locality and for many other such things which individually we are unable to attend to. All such needs of ours are, therefore, looked after by the Government. We are

supposed to be aware that Government functions at three levels, i.e., the local level (Panchayats, Municipal Councils, Municipal Corporations Notified areas etc.), the state level (State Government), and at the Central level (Central Government). Some of the functions which require to be attended to locally are entrusted to local bodies; functions like primary education; law and order are seen to by the State Government, whereas defence, planning, currency etc., are under the charge of the Central Government.

You will appreciate that to discharge these obligations the Government needs funds and these funds are collected by way of taxes. Local bodies collect property tax, octroi etc., whereas the State Government's major share comes from Sales Tax. The Central Government collects income-tax, wealth-tax, gift-tax, customs, excise, etc. This is according to the provisions contained in the Constitution of India.

It may be stated here that though Income-tax is collected by the Central Government, the proceeds from it are distributed among the States on the basis prescribed. For determining the basis, a Commission known as the Finance Commission is appointed by the President of India for every five years and on the basis of its recommendations, the proceeds from Income-tax are distributed. The formula of distribution thus goes on changing. However, we are not interested in the formula as such; but we mention here only for the sake of general commercial knowledge.

You have read about a few taxes being levied by various Governments in the earlier paragraphs and naturally the question arises whether these taxes could be classified and suitable names given. Yes, taxes can be classified as direct and indirect. Direct taxes are those which are borne by the persons who pay it and these cannot be shifted to anybody else. For example, Income-tax is ultimately borne by the person who pays it. If you pay Rs. 5,000 by way of Income-Tax, you cannot pass on the burden (known as incidence in public finance) to any other person. On the other hand indirect taxes are those which are paid by one man and the burden is borne by the other. For example, sales tax is paid by the shop-keeper but do you think he pays it from his pocket? No, certainly not. He collects it from the customers and then pays the same to the Government. Though he is the person who pays sales tax, the burden of sales tax is passed on to the customer who ultimately bears it. Sales Tax is, therefore, classified as indirect tax. With these introductory remarks, I am sure you will now get ready to follow as to how the income-tax has developed in this country and what the necessity has been for having it at all.

1.2 A BRIEF HISTORICAL ACCOUNT OF THE INCOME-TAX LAW IN INDIA

The first liberation movement known as the Sepoy Mutiny also resulted in financial difficulties for the foreign Government and thus came the law of taxation on income in India. A few experiments were made with the contents and nomenclature, and then appeared on the scene the Income-Tax Act, 1886, which continued for about three decades. Once again financial difficulties were felt after the First World War and with a few experiments here and there, a new Act was enacted viz., Indian Income-Tax Act, 1922. This Act worked quite satisfactorily for about forty years.

During this period India got independence and we felt the necessity for overhauling the system. The matter was referred to the Law Commission in 1956. It submitted its report on 26th

September, 1958 and gave a draft bill for adoption and enactment. Mahavir Tyagi, in the mean time, was asked to look into the direct taxes and a committee under his chairmanship was appointed in 1958. The Committee was popularly known as the Direct Taxes Administration Enquiry Committee. With all this preparation on the part of the Government, a new bill was drafted. With this, the old Indian Income-tax Act, 1922 was replaced and a new Act, namely, Income-Tax Act, 1961 was enacted. It came into force with effect from 1st April, 1962.

1.3 THE INCOME-TAX ACT, 1961

The Income-tax Act, 1961 extends to the entire country. It contains more than four hundred fifty sections though serially speaking, there are 298 sections. It is so because many of the sections have been inserted with numbers followed by alphabets like 80A, 80C, 271A, 271B etc. The Act also contains Nine Schedules. All these Sections and the Schedules would be discussed throughout the study. The students at this level are not required to memorise the section numbers though it is always preferable to remember some important sections and support your views on law by quoting Sections of the Act.

APPLICABILITY OF THE ACT

Section 1 of the Act is relevant in this regard. It says that the name of the Act would be the Income-Tax Act, 1961. It will extend to the whole of India. It came into force on 1st April, 1962.

Please note that the title of the Act is the Income-Tax Act, 1961 but it has come into force from 1-4-1962.

1.4 INCOME-TAX RULES, 1962

At the time of drafting of any Act, it is not possible to conceive of all possible situations and provide for them. There are circumstances which remain unseen by those who draft any enactment. Another important point is that sometimes the Legislature desires to give some powers to those who would administer the Act. It is left to them to make rules in those areas which have not been specified in the Act. In the Act these situations are mentioned where the decisions have to be taken by the Department that is, the administrators. For example, in the Income-Tax Act, 1961, rates of depreciation have not been provided for and the relevant section mentions that depreciation would be allowed at the prescribed rates. These rates have been mentioned in the Income-Tax Rules, 1962. The administration of the Act is looked after by one Board, which is known as Central Board of Direct Taxes (CBDT). It is the Board under whom the department of Income-Tax functions. This Board itself works under the supervision of the Ministry of Finance, Government of India.

The Board has framed rules, which are known as Income-Tax Rules 1962. These Rules contain various forms and miscellaneous details. When the Board desires to have some rules framed, it is to be notified first in the draft form for public deliberations. Then they are notified for adoption, may be in the modified form, in view of the debate which is supposed to have been generated on the notification of the draft rules. Once the rules are notified for adoption, they will be placed on the table of the house for information. These rules are amended from time to time as the circumstances warrant keeping in view the changing requirements. It is, therefore, necessary that those who are interested in the study of Income-Tax are also required to know the contents of these rules. Not only this, those who are meticulous in knowing everything upto date should make it a

point to keep in touch with the tax journals and other literature to keep them abreast of all the latest amendments.

In addition to what is contained in these rules, the Board issues, from time to time, certain circulars for the direction of the departmental officials. There are certain other circulars which are notified for the benefit of the public and the assesseees. A word of caution is necessary here. Do you think that the Board can issue circulars which are contrary to the letter and spirit of the law contained in the Income-Tax Act? You will certainly say in emphatic terms 'No'. Therefore the Board takes special care to see that the rules issued by them are in conformity with the law. In case any Rules go against the law as contained in the Income-Tax Act, such rules could be challenged in the Court and are likely to be struck down by the Court. Similarly department circulars are only by way of guidelines for the benefit of Income-Tax Officers and others.

1.5 THE FINANCE ACT

It is a common knowledge that the Finance Minister of the Government of India presents the Budget of the country every year on the last day of February generally. It is a convention. However, if there are some pressing reasons or if the country passes through the general election and the Government feels that it did not have enough time to devote to the budget making exercise, the presentation of the budget may be delayed. The budget contains the expenditure programme of the country in the coming financial year. Accordingly, the Finance Minister presents certain proposals to augment income. All these proposals are presented to the Parliament in budget speech. The proposals so presented are placed on the table of the House by way of a Finance Bill. It contains his proposals in the areas of direct and indirect taxes. In it there are also given the rates of income-tax at which the assesseees would be asked to pay income tax in the ensuing year. It contains the various proposals in the areas of customs and excise. This bill is passed into an Act. Since it is an annual exercise, and since the tax is collected at the rates given in the Finance Act, it is necessary to update one's knowledge by studying the Finance Act, of the latest year. These units are thus based on the following:

The Income-Tax Act, 1961 Amended upto-date,

The Income-Tax Rules, 1962 Amended upto-date

Direct Tax Laws (Amendment) Act, 1989

The Finance Act, 1992.

Thus whatever you are studying here is the latest in Income-Tax Act, 1961, and is applicable to the tax efforts of the Government of India in the financial year 1992-93.

1.6. SCHEME OF INCOME-TAX-AN OVERVIEW

Every person, whose total income (as computed according to the provisions of the Income-Tax Act and the Income-Tax Rules etc.) is more than the tax free limit, is required to pay tax. Income is earned first and then tax is paid. We may put in other words. Income is earned in one year and tax is paid in the year following it.

Then the term, 'Person' includes individuals, partnership firms, hindu undivided families, association of persons, companies, trusts etc. In other words all these entities are required to pay tax.

The Income-Tax Act, 1961 has identified five heads under which income can be earned. They are: Salaries, Income from House property, Profits and Gains from Business or Profession, Capital Gains and Income from Other Sources. Whatever may be the source of income a person is having, it will fall under either of these five heads. The Act contains provisions for computation of income under these heads.

There is a possibility of getting negative income or loss while computing income under a particular head. Suppose total receipts under a particular head are less than the expenses incurred thereunder, the net result will be a loss. Such losses could be set off against income from other heads. In case there is a loss without a matching income under any other head, it would be carried forward for set off in the next year. This scheme is explained in the Act.

The Act contains a detailed scheme of appeals and revisions. Suppose, you as an assessee, are not satisfied with what has been done by the Assessing Officer (A.O.) in the determination of your total income. In such a case you have a right to appeal to higher officers and courts prescribed in the Act. This helps the assessee to seek justice.

It is also possible that persons having taxable income may not care to submit the return or keep on postponing the payment of tax even when demanded by the A.O. There are provisions to deal with such cases also.

Check your progress-I

- i) What does the term 'person' include?

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- ii) List out the sources of income.

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1.7 CASE LAW

It may be noted that disputes between the Income-Tax Department and the assessee are sometimes referred to the courts for decision. The Department approaches the court in the name of the Commissioner of Income-Tax whereas the assessee himself appeals to the court for hearing. The case is heard and decision given by the court. The decisions on the issues settled could be cited

before the Income-Tax authorities subsequently. It is therefore necessary that some of these decisions should be remembered for support by the Income-Tax authorities. We would be giving some case law throughout the discussion not so much for remembering them for the examination, but for making use of them in actual life.

1.8. POINTS TO BE NOTED IN THE STUDY OF INCOME-TAX

1. Income is earned in one year and is taxed in subsequent year. For example, income earned in the year 1991-92 will be taxed in the year 1992-93.
2. It is the law that prevails on the first day of the tax year, that will be applicable to the assessment of income earned in the previous year. In this case, for example, the law as it prevails on 1-4-1992 will be applicable to the assessment of income earned in the financial year 1991-92.
3. Since the rates of income-tax are not stated in the Act, we have to refer to the Finance Act which is enacted at the beginning of the tax year. For example, income earned in the year 1991-92 will be taxed according to the rates specified in the Finance Act, 1992.
4. We have stated earlier that the income-tax provisions are ever changing. It is therefore recommended that the students study only the latest books and other relevant material and must not be tempted to refer to the old books.
5. Sometimes, there are certain issues on which the assessee (tax payer) is not satisfied. For solving such things he has a right to move the courts including High Court and Supreme Court.
6. There are situations when different High Courts give different opinions on certain points. In such a case the opinion of a particular High Court would be followed in the jurisdiction it commands. The verdict of the Supreme Court is acceptable throughout the country.
7. The judgements delivered by various courts are published periodically in various journals. Some of them are as under:-

Income-Tax Reports	Published from Madras
Current Tax Reporter	Published from Jodhpur
Taxation	Published from Delhi
Taxman	Published from Delhi
Calcutta Tax Bulletin	Published from Calcutta.

1.9 SUMMING UP

Income-tax is an important source of revenue and is considered to be a direct tax. It is direct because the burden of tax is borne by the same person who pays it unlike indirect taxes where the

person who pays taxes does not bear them but passes them on to another person. Sales-Tax, Excise, Customs etc., are the indirect taxes.

The Income-Tax Act, 1961, is a little complicated piece of legislation and is sufficiently a large Act. It is not enough if we study only the Act. It is necessary that Income-Tax Rules framed by the Central Board of Direct Taxes are also to be studied and our knowledge should be upto-date. As the Act keeps changing often and the Board goes on framing rules whenever it feels the necessity of doing so, it is necessary that the person who adopts taxation as a profession should keep track of all such amendments. In addition, one will also be interested in keeping track of the High Court and Supreme Court judgements because it is only from the study of the case law that one is able to grasp the interpretation of sections properly.

1.10 CHECK YOUR PROGRESS : MODEL ANSWERS

- i) The term 'person' includes, Individuals, Partnership Firms, Hindu Undivided-Families, Association of Persons, Companies, etc.
- ii) For Income-tax purpose, various sources of income are grouped into five heads. They are (i) Salaries (ii) Income from House Property, (iii) Profits and Gains from Business or Profession, (iv) Capital Gains and (v) Income from other sources.

1.11 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following in about 30 lines each:

1. Describe the scheme of the Income-Tax Act.
2. Discuss the important points in the study of the Income-Tax Law.

II. Short Questions

Answer the following in about 15 lines each :

1. Describe the importance of the Finance Act enacted every year.
2. Give a brief historical account of the Income-Tax law in India.
3. What are direct and indirect taxes? Give examples.
4. What is contained in the Income-Tax Act, 1961 ?
5. Why should we study the Income-Tax Rules ?

1.12 SUGGESTED READINGS

The suggested readings given hereunder will hold good throughout the course :

1. Indian Tax laws 1992 edition Company Law Institute, Madras

2.	Indian Tax Law Rules 1992		do
3.	Income-Tax Law		Chaturvedi and Pithisaria
4.	Income-Tax		Palkhiwala
5.	Income-Tax Act		Aiyar
6.	An outline of Income-Tax Law, 1992		Bhagwati Prasad
7.	Income-Tax Law and Practice, 1992		Sukumar Bhattacharya

Note

The suggested readings given under 1 and 2 are bare Act and Rules; from 3 to 5 are law books and a familiarity of the contents will make you confident. In fact when you have a desire to start your own practice or work as tax assistant in some concern, it is necessary that you know how the commentaries are consulted. The last two are text books and will be useful. However, you will read only the latest editions.

Journals

Following journals are useful:

1. Taxation (monthly).....New Delhi
2. Incomes-Tax Reports (weekly).....Madras
3. Current Tax Report (Monthly).....Jodhpur

Journals of the Institutes

The following two journals are helpful in ways more than one. They publish many articles of common interest including tax matters and one may keep in touch with these journals either by regularly consulting in the library or subscribing for them:

1. The Chartered Accountant The Institute of Chartered Accountants of India, New Delhi-110 002.
2. Chartered Secretary The Institute of Company Secretaries of India, 22, Institutional Area, New Delhi - 110 003.

UNIT - 2: DEFINITIONS

Contents

- 2.0 Aims and Objectives
- 2.1 Introduction
- 2.2 Definitions as per Section-2
- 2.3 Previous Year (Section-3)
- 2.4 Summing Up
- 2.5 Check Your Progress-Model Answers
- 2.6 Model Examination Questions

2.0 AIMS AND OBJECTIVES

While studying the Income-Tax Act, we come across a number of terms which need understanding and which will pave the way for study. The objective of this unit is to explain the terms which are defined in Sections 2 and 3 of the Income-Tax Act, 1961.

On completion of this unit, you should be able to:

- define Agricultural Income;
- explain the term 'Income';
- define the terms 'Assessee' and 'Assessment Year';
- define the term 'Person'; explain 'Previous Year'.

2.1 INTRODUCTION

To understand the underlying meaning of any term, we generally consult the dictionary or the encyclopedia. This general rule is accepted universally. However, terms carrying special meanings are used in certain legislations. While enacting any law the Government define the terminology in section 2, generally. Special care is taken to define the terms when they are used to carry specific meanings which are not common. It is, therefore, necessary to study these terms before starting a study of the subject. There are court decisions also in this respect. Courts will accept the dictionary meanings of any term if it is not defined in the Act. Where the term has been defined in the enactment, the definition will have precedence over the dictionary meaning.

2.2 DEFINITIONS AS PER SECTION-2

We do not propose to give here all the terms defined in the Act because some of them are either not relevant at undergraduate level or certain terms require explanation at a place where they are used. We are giving here only those definitions which are important for understanding the subject.

Agricultural Income [2(A)]

Agricultural income has not been taxed right from the beginning under the Income-Tax Act. The justification for such exemption is that income from agriculture is taxed in the form of land revenue. Another reason is that agriculture being a State subject, the Central Government is not entitled to tax this source of income. The State Government is in fact, doing so. The position under the Income-tax Act is that Section 10 (1) exempts agricultural income from Income-Tax. Because of the exemption it enjoys, it is necessary to understand the definition of the term 'Agricultural Income' properly.

Agricultural income as defined under Section 2(1A) includes the various types of incomes as follows:

(1) Any rent or revenue derived from land which is situated in India and used for agricultural purposes [2(1A)(a)]

Rent is the payment in cash or kind for the grant of a right to use land which is owned by one person but used by the other. Revenue indicates any yield or income. Rent or revenue will be agricultural in nature only in the following cases:

- (a) Rent or revenue is derived from land.
- (b) Land is situated in India, and
- (c) Land is used for agricultural purposes.

(2) Income derived from such land by agricultural or from manufacturing process [2(1A)(b)] :

Income to be included here is conditioned by the words "such land" meaning thereby that only that income will be termed as agricultural in nature in which case, the land is situated in India and is used for agricultural purposes. The incomes from the following activities and derived from land are included here:

- i) Agriculture
- ii) Process ordinarily employed by a cultivator to render the produce marketable.
- iii) Sale by cultivator of the produce without any further processing except one which is covered by (ii) above.

The process which the cultivator may employ should be such as is generally employed by all the cultivators to make it fit for marketing. It may be manual or may involve the use of machinery or power. Tobacco leaves are generally dried before being sold and therefore, income from the sale of dried tobacco leaves will be agricultural in nature.

(3) Income from agricultural house property or farm buildings [2(1A)(c)]

Any income derived from any building owned and occupied by receiver of rent in kind or by the cultivator will also be agricultural income if the following conditions are fulfilled:

- The building is on or in the immediate vicinity of agricultural land in India;
- It is occupied by the agriculturist or the receiver of rent in kind;
- The agriculturist needs it by reason of his connection with the land and uses it as a dwelling house, store house or as an out house;
- The land on which such building is situated must be subject to land revenue in India or subject to a local rate assessed and collected by officers of the Government as such; and
- If the land is not subject to land revenue, it must be outside the urban area, i.e., area comprising a cantonment board, municipal corporation or any other name by which it is known, which has a population of 10,000 or more.

Note

If the person has let out his land on rent which he receives in kind of the produce, he is termed as 'receiver of the rent-in-kind'. Where land is used by the receiver of rent in kind for carrying out the process to make the produce marketable or where he derives any income on sale of such produce, this will be agricultural income in his hands too, as it is in the hands of a cultivator.

In order to constitute income, there should be a nexus between such income, land and agricultural operations. The immediate source of income must be the land of the description or character mentioned in the definition. The land must also be used for agricultural purposes.

'Agricultural Purposes' Defined

The decision given by the Supreme Court in CIT vs. Raja Bennoy Kumar Sahas Roy will be of much help in understanding: 'agriculture' and 'agricultural purposes'. The relevant portion from the judgment is given below:

- Agriculture in its primary sense denotes cultivation of the field and is restricted to cultivation of the land which means tilling, sowing of seed, planting and similar operations on land.
- In addition to the above, operations to be performed subsequently like "weeding", 'digging' etc.
- 'Agriculture' comprises within its scope all produce 'regardless of the nature'. The produce may be grain, vegetable or fruits including tea, spices, tobacco or commercial crops like cotton, jute, etc.

The following incomes though connected with land are not agricultural incomes:

1. Annuity-payable to vendor of agricultural land or payable to a person giving up his claim to a piece of agricultural land.
2. Commission for selling agricultural produce.
3. Income from Dairying.

4. Income from Brick-Making.
5. Income from Fisheries.
6. Income from Forest produce of wild growth.
7. Income from ginning cotton.
8. Profit earned on the sale of standing crop purchased.
9. Income from letting out land for stocking timber.
10. Income from manufacturing salt from sea water.
11. Dividend from a company engaged in agriculture.
12. Income from Nursery is not necessarily agricultural income unless maintained by a farmer as an aid or necessary adjunct to the primary process of agriculture.
13. Income from quarries.
14. Income from rearing of silk worms-by feeding on leaves of mulberry trees grown on own farm-land.
15. Income from sale of silk cocoons.
16. Income from poultry farming.
17. Royalty income from mines.

the following incomes are agricultural incomes :

1. Profit on the sale of standing crop by a cultivating owner or tenant of land.
2. Income from growing flowers and creepers.
3. Groves-Income from groves in which trees were planted on land and basic agricultural operations were also performed to foster their growth and preservations.
4. Pasturage - The grazing fees collected from owners of cattle, normally used for agricultural purposes.
5. Shared profit of a partner from a firm engaged in agricultural operations.
6. Income derived from running a dairy which is incidental to agriculture.
7. Income from the sales of dried tobacco as tobacco leaves are ordinarily dried to make them fit for sale.
8. Sums received from an insurance company for damage caused by hailstorm to the green leaf forming part of the assessee's tea garden.

Partly Agricultural Income : There are certain incomes which are neither wholly agricultural in nature nor can they be said to arise from business. On the other hand they include some elements of agriculture and some those of business. Profits of a sugar mill which grows its own sugarcane can be cited as one of the examples.

Income of a Sugar Mill growing its own sugar cane : In the case of a sugar mill which grows its own sugarcane, the profit earned up to the point of harvest will be agricultural in nature whereas the profits yielded by the crushing and manufacturing operations will be taxable as non agricultural income. We have to find out the market value of the crop from which are deducted all expenses of cultivation. The resultant figure will be agricultural income. Income earned by further processes will be taxable.

Income from the manufacture of Tea : Income derived from the sale of tea grown and manufactured by a seller in India shall be computed as if it were income derived from business and 40% of such income shall be deemed to be income liable to tax.

Treatment of Agricultural Income for Tax Purpose

Agricultural income is exempt under Section 10(1). However, subject to the fulfilment of the following conditions, agricultural income is to be partially integrated with the non-agricultural income to determine tax liability of an assessee:

- i) The assessee must be an Individual, HUF, Unregistered Firm, Association of Persons or Body of Individuals.
- ii) The assessee should have net agricultural income exceeding Rs.600/-
- iii) The amount of non-agricultural income should exceed maximum tax free amount (Rs.22,000 in the case of an Individual, HUF, Unregistered Firm and Rs.12,000 in the case of specified HUF).

The following are the three steps to be followed for computation of tax liability where the assessee has agricultural income satisfying the above conditions.

- i) Agricultural and non-agricultural income will be aggregated and income tax on the total amount will be calculated.
- ii) The net agricultural income and the maximum tax free non-agricultural income will be aggregated and income tax thereon will be calculated.
- iii) The amount of income tax calculated under step (ii) will be deducted from the income tax calculated under step (i). The balance is the amount of income tax payable. If the total non-agricultural income exceeds Rs.75,000; surcharge of 12% will be added to this tax.

Note: The net agricultural income will be determined after making all the allowable deductions from gross agricultural income.

Check your progress-1

Decide whether the following incomes are agricultural incomes or not:

- i) Income received as interest on arrears of rent payable in respect of agricultural land.
- ii) Income from sale of trees of spontaneous growth.
- iii) Dividend paid by a company out of its agricultural income.
- iv) Sale of crop received as rent in kind.
- v) Ginning operation carried on by the owner of the land on unginned cotton.

Assessee [2(7)]

The term assessee has been defined in clause 7 of Section 2. 'Assessee' means a person by whom any tax or any other sum is payable under this Act. It includes the following:

- (a) Every person in respect of whom any proceeding under this Act has been started for the assessment of his income.
- (b) Every person who is assessable in respect of income of any other person.
- (c) Every person to whom refund is due.
- (d) Every person who is deemed to be an assessee under any provision of this Act.
- (e) Every person who is deemed to be in default under any provision of this Act.

You will notice that the definition of the term 'assessee' is very wide. It includes even the person who may not have assessable income but who has to be assessed in respect of income derived by others. There are situations of this type which we will study during the course of the year. Similarly even that person is called an assessee who is deemed to be an assessee in default. A person will be in default when he is required to make payment for and on behalf of others and fails to do that.

Assessment Year [2(9)]

"Assessment year" (A.Y.) means the period of twelve months commencing on the 1st April every year. In other words you may say that the financial year in which assessment takes place is the assessment year. For example, the current financial year, namely, 1992-93 is the assessment year for the incomes earned in 1991-92. Therefore we may conclude that a particular financial year is the assessment year in relation to a particular income.

Average Rate of Income-Tax [2(10)]

Income-tax is levied at progressive rates applicable to different slabs of income. The rates vary from 20 to 50%, the first slab of Rs.22,000 being tax free. After computing tax liability according

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to the prescribed rates, from that amount we have to deduct rebate allowable u/s 88 of the Act. On the remaining amount, if the Total Income of the assessee exceeds Rs.75,000 we have to calculate surcharge @ 12% (This is for the AY 1992-93).

To find out the average rate of income tax, the amount computed according to the above mentioned procedure should be divided by the total income and multiplied by 100. The result will be the average rate of income tax.

$$\text{Average Rate of Tax} = \frac{\text{Income} - \text{tax on total income}}{\text{Total Income}} \times 100$$

The average rate of income tax is significant for two reasons. The tax payer will know the rate at which he is required to pay income-tax on his total income. Secondly if there is some amount in respect of which rebate at average rate is to be given, it helps us to calculate the quantum of rebate on the rebatable amount. Needless to mention that the tax payable will be the amount of tax minus the rebate allowable.

Board [2(12)]

"Board" means the Central Board of Direct Taxes constituted under the Central Board of Revenue Act, 1963.

It is this Board that is entrusted with the job of administering the various direct tax laws. We would be mentioning this as C B D T also throughout our study. It is this Board that frames Income-Tax Rules and issues notifications and circulars from time to time.

Child [2(15-A)]

"Child" in relation to an individual includes a step child and an adopted child of that individual.

Co-operative Society [2(19)]

"Co-operative Society" means a co-operative society registered under the Co-operative Societies Act, 1912 or under any other law for the time being in force in any state for the registration of co-operative societies.

Director, etc. [2(20)]

"Director", "Manager" and "Managing Director" in relation to a company have the meanings assigned to them in the Companies Act, 1956.

Income [2(24)]

The term 'income' is most important from the view point of taxation. It is the income that is taxed. If you have received an amount and can prove that the amount is not at all income, you would not be asked to pay income-tax because you have not derived any income at all. It is therefore necessary that the term is defined properly. But you would be surprised to learn that the term has not been defined exhaustively. What the Income-Tax Act, has defined in section 2(24) is the inclusive definition. They have given certain items and have held them as income. They have not

given the characteristics of income so that we can go on testing various items to determine whether they are incomes at all.

Section 2(24) defines 'income' to include the following items:

- (i) Profits and gains.
- (ii) Dividend.
- (iii) Voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes. Contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be income.
- (iii) The value of any perquisite or profit in lieu of salary (Such as the value of rent free accommodation provided by the employer or insurance or annuity premium paid by the employer).
- (iiia) Any special allowance or benefit, other than perquisite involved under sub-clause (iii), specially granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.
- (iiib) Any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.
- (iv) The value of any benefit or perquisite obtained from a company either by a director or by a person who has substantial interest in the company or by a relative of the director or such person.
- (iva) The value of any benefit or perquisite whether convertible into money or not which is obtained by a beneficiary or trustee from a trust will be treated as taxable income in the hands of the beneficiary or the trustee as the case may be.
- (v) Any compensation or other payment made to a person managing the affairs of a company in connection with the termination of his office and income derived by a trade, professional or similar association for specific services rendered or done to its members and chargeable profit under section 59.
- (va) Any sum chargeable to tax u/s 28 (iiia)
- (vb) Any sum chargeable to tax u/s 28 (iiib)
- (vc) Any sum chargeable to tax u/s 28 (iiic).
- (vd) The value of any benefit or perquisite whether convertible into money or not, arising from business or the exercise of a profession under section 28 (iv).

- (vi) Capital gains arising from the transfer of a capital asset.
- (vii) The profits or gains of a mutual or co-operative insurance company computed in the prescribed manner.
- (viii) Omitted w.e.f. 1-4-1988.
- (ix) Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or betting of any form or nature whatsoever.
- (x) With effect from Assessment Year 1988-89, any sum received by employer as contribution from employees towards any provident fund or superannuation fund or any fund set up under Employees State Insurance Act, 1948, for the welfare of such Employees.

It may be important for readers to know at this stage that winnings from lotteries, crossword puzzles and races etc., have been included in the term 'income'. However, according to the notification of the Board, they are treated as casual incomes and therefore tax free up to Rs.5,000. These will be taxed only in excess over this amount.

The definition given above does not define the concept but simply says that certain amounts are included in the term "income" and therefore they are taxable. In the absence of any guidelines available from the Act, we have to depend upon the various judgments of High Courts and Supreme Court. On the basis of some of them we tried to formulate, certain characteristics of income on the basis of which we may decide whether a particular amount is income or not.

1. The word income connotes a periodical monetary return coming in with some sort of regularity from definite sources. The source need not be continuously productive but must be one whose object is the production of income.
2. Income is essentially the produce of something. It is not correct to say that every receipt which is not capital receipt is assessable income.
3. Income is the annual or periodical yielding money or reducible to a money value arising from the use of real or personal property.
4. The word 'income' signifies what comes in and includes sums which have become due.
5. The element of periodical receipt or regularity or expected regularity of monetary return is an essential ingredient of 'income'.
6. There is no absolute rule that the income must always be of recurrent nature. Income has an infinite variety of forms and a single receipt may be income.
7. A receipt which is income does not cease to be income even if exempted from tax.
8. Income may also be defined as the gain derived from land, capital or labour or any two or more of them.
9. Income means real income and not fictitious or technical income.

10. income must come from outside. Pocket money received by a student from his father is not income.
11. It does not matter if the income is gained illegally. Incomes received in the exercise of some illegal practices will be chargeable to tax though the tax payer may still be prosecuted for the mistakes of omissions and commissions.

Gross Total Income:

The aggregate of income computed under the following five heads before making any deduction u/s 80 CCA to 80 U is termed as gross total income:

- a) Salaries.
- b) Income from House property.
- c) Profits and Gains from Bussiness or Profession.
- d) Capital Gains.
- e) Income from Other Sources.

Total Income [2(45)]:

Total income of an assessee is aggregate of income computed under the above five heads as reduced by the deductions permissible under sections 80 CCA to 80 U.

The scheme of computation of gross total income, total income and tax liability thereon can be easily understood with the help of the chart given at the end of Block – II.

Person [2(31)]

The term 'person' includes the following:

- (i) an individual;
- (ii) a Hindu Undivided Family;
- (iii) a company;
- (iv) a firm;
- (v) an association of persons or a body of individuals whether incorporated or not;
- (vi) a local authority;
- (vii) every artificial juridical person not falling within any of the categories mentioned above.

Ex: Lord Venkateshwara of Tirupati

All these persons described above are liable to pay tax under the Income-Tax Act, 1961.

2.3 PREVIOUS YEAR (SECTION-3)

Income which is earned or received in a certain year is assessed to tax in the next year. In Income Tax Act, the year of earning or receipt of income is referred to as previous year and in popular parlance it is called the Accounting Year/Income Year.

Previous year with effect from Assessment year 1989-90

The Direct Tax laws (Amendment) Act, 1987 has changed the definition of previous year with effect from 1st April 1989. Accordingly, all the assesseees will be required to follow a uniform previous year which will end on 31st March for all sources of income. Thus, the option given earlier to assesseees in choosing different periods as previous years for different sources of income is withdrawn.

According to new Section-3 as substituted by Direct Tax Laws (Amendment) Act, 1989 to be effective from 1st April 1989, previous year has been defined as follows:

1. Previous year means financial year immediately preceding the Assessment year [Section 3(1)]. Thus for the Assessment year 1992-93, the previous year consists of 12 months commencing from 1st April 1991 and ending with 31st March, 1992.
2. Previous year of a new Business or profession set up in Financial year [proviso to Section 3(1)] :

Where a new business or profession is set up or a new source of income comes into existence in the Financial year preceding the Assessment year, the first previous year for such new business or profession or source of income starts on the date of its beginning and ends on 31st March of the said Financial year. The period may be less than 12 months.

Exceptions to the General Rule

As a general rule, it is only the income of the previous year that is put to tax in the assessment year and the rule is universally applicable.

However, there are situations when application of this rule is given a good bye because the Government feel that by applying the rule in certain situations the Revenue will stand to lose. That means to say, certain times, the income earned in the previous year will be taxed in the same year, instead of in the assessment year. These are the situations forming exceptions to the general rule regarding previous year:

1. Income of Non-Resident Shipping Company :

Section 172 provides for the taxation of income of non-resident shipping company in the year in which the income is earned, provided that such shipping company does not have a representative in India. In such cases, before, the ship of the company is allowed to leave the port in India, master of the ship will prepare and furnish a return to the A.O. of full amount paid or payable to the owner on account of the carriage of passengers, livestock, etc. The A.O. on receiving such return shall immediately assess the income and determine the tax payable. You will appreciate that in this case if the income is not taxed immediately, the Government cannot collect income tax from the owner

of the ship who does not have an office in India and does not have any representative who will be obliged to pay the tax when demanded.

2. Persons Leaving India [174]

When it appears to the A.O. that any individual may leave India during the current assessment year and that he has no intention of returning to India, the total income of such person for the period from the expiry of the last previous year to the date of his departure shall be assessed in that year only, irrespective of the provisions of section 4 regarding previous year.

For example, Prof. Singh who has been assessed regularly all along desires to leave India for settling down in USA. He is leaving on 18th August, 1991. In this case, the A.O. has authority to ask Prof. Singh to pay tax on the income earned by him between 1-4-1991 to 18-8-1991 in the previous year itself. That means, according to the general rule that income is taxable in the Assessment Year 1992-93. But as an exception to it, u/s 174 the A.O. can ask the assessee to pay tax on that income in previous year itself.

3. Persons Trying to Alienate their Assets [175]

If it appears to the A.O. during any current assessment year that a person is likely to sell, transfer or dispose of any of his assets with a view to avoiding payment of any liability under this Act, he shall commence proceedings for assessment of his income for the period from the expiry of the last previous year to the day when such proceedings commence. This will be done notwithstanding, the provisions of Section 4.

4. Income of Discontinued Business [176]

Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the last previous year upto the date of such discontinuance may be charged to tax in that assessment year at the discretion of that A.O. To make this section operative, it has been provided in Section 176, that any person discontinuing any business or profession shall inform the A.O. of such discontinuance within fifteen days thereof.

Check your progress - 2

What does the term 'person' include?

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.....

.....

.....

Check your progress - 3

What will be the previous year in case of newly set up business?

.....

2.4 SUMMING UP

The Act defines certain terms and it is necessary to understand those terms in the context of the definition given. Agricultural income is not taxable and therefore, it has been defined quite exhaustively. It includes not only the income from cultivation but rent received for hiring out agricultural land is also agricultural in nature. Income derived from sugar making or by tea companies can be partly agricultural in nature only when the sugar mill grows sugarcane for making sugar and the tea company owns tea plantations.

The definition of the "Income" is not comprehensive but it is inclusive. It enumerates certain items which would be income under the Act. Most important items are lotteries, winnings from horse races etc., which have been included in the term "income". Previous year and assessment year are other important definitions.

2.5 CHECK YOUR PROGRESS : MODEL ANSWERS

- 1.i) There is no direct relationship between the land and the income. Hence, it is not agricultural income.
- ii) No basic operations of agriculture have been carried out. Hence, it is not agricultural income.
- iii) It is not agricultural income in the hands of recipients.
- iv) Rent derived from agricultural land is agricultural income whether received in cash or kind.
- v) As unginned cotton can be sold in the market in its original form, it is not agricultural income.
- 2.i) an individual,
- ii) HUF,
- iii) a Firm,
- iv) a company,
- v) an association of persons or body of individuals,
- vi) a local authority,
- vii) every artificial person.

3. The period between commencement of such business and 31st March next following.

2.6 MODEL EXAMINATION QUESTIONS

I. Essay questions

Answer the following in about 30 lines each:

1. Define 'Agriculture income'.
2. Explain the term 'Income'.
3. Describe the characteristics of 'Income'.
4. What is 'previous year'? Describe its importance.
5. Are the following incomes?
 - (i) Gift of a sum of Rs.10,000/- made by a husband to his wife on her birth day.
 - (ii) 'Prize' received in Orissa State Lottery and cross-word puzzle competition.
 - (iii) 'Stakes' won in a horse race and at bridge table in card play.
 - (iv) Tips received by a waiter in 'Ashoka Kalinga Hotel, Bhubaneswar.
 - (v) 'Pugree' realised by the landlord from tenants for letting out shops.

II. Short Questions

Answer the following in about 15 lines:

1. Define Assessee.
2. What is average rate of income tax?
3. Illustrate the determination of assessment year in case of newly started business.
4. What are the exceptions to the general rule that income of the previous year alone is taxable in the assessment year.
5. How do you treat agricultural income for income tax purposes?
6. Define the following terms:
 - i) Assessment year,
 - ii) Person
7. Explain the rule of taxability of income as regards 'previous year'.

UNIT - 3: CAPITAL AND REVENUE

Contents

- 3.0 Aims and Objectives
- 3.1 Introduction
- 3.2 Meaning of Capital and Revenue
- 3.3 Capital Receipts
- 3.4 Revenue Receipts
- 3.5 Capital Expenditure
- 3.6 Revenue Expenditure
- 3.7 Illustrations
- 3.8 Summing Up
- 3.9 Check Your Progress: Model Answers
- 3.10 Model Examination Questions

3.0 AIMS AND OBJECTIVES

The objective of this unit is to give adequate material to you on capital and revenue and develop your skill in identifying the same.

After reading this unit, you should be able to :

- explain the meaning of capital and revenue;
- distinguish between capital receipts and revenue receipts;
- distinguish between capital expenditure and revenue expenditure.

3.1 INTRODUCTION

Income-tax is levied on income, i.e., revenue receipts less admissible expenses and losses. Capital receipts are not taxed. However, the demarcation between revenue and capital items is often difficult to be drawn. As such, the distinction between capital and revenue is important for the purpose of income tax. Unless this distinction is clear, it would be difficult to compute one's tax liability correctly. It is the revenue receipt that is taxable and not the capital receipt. For example, I sell my gold ring for Rs.2,000/- Do you think it is my income? Certainly not. Will I be required then to pay income-tax on this amount of Rs.2000. No, because, it is not my income. It is simply conversion of some asset into cash. On the other hand, I serve a client of mine and he pays me my fees of Rs.1,000 for the consultancy provided by me. Is it my income? Yes. Should it be taxed? Yes.

Again it is not the total receipts that would be chargeable to tax. It is the 'income' that is taxable. Total income is arrived at by deducting revenue expenditure from revenue receipts. For example total collection at the counter of a hotel is Rs.5000 per day. Is it all income? No. It is only the revenue receipt. In order to earn this receipt, the owner must have spent some amount on buying provisions, paying employees, incurring miscellaneous expenditure by way of paying for the fuel, power, water, etc. Assuming that all such amount to Rs.4,200 per day, we will say that the excess of that revenue receipts (Rs.5,000) over the revenue expenditure (Rs.4,200) is income and thus the hotel owner will be required to pay tax only on Rs.800.

3.2 MEANING OF CAPITAL AND REVENUE

Revenue and capital are also known as recurring and non-recurring. Any expenditure that does not repeat generally is non-recurring. For example, kitchen expenses as regards provision, fuel etc. are of repetitive type and therefore revenue or recurring. But the expenditure incurred in buying an electric or gas heater is certainly not to be incurred every now and then. It is termed as capital or non-recurring.

The following points are expected to throw some more light on capital and revenue.

1. If the expenditure is for the *initial outlay* or for acquiring or bringing into existence an asset or advantage of enduring benefit to the business that is being carried on or for extension of the business that is going on, or for substantial replacement of an existing business asset, it would be capital expenditure.
2. *Running Business*: If, on the other hand, the expenditure although for the purpose of acquiring an asset or advantage is for running of the business or for working out that asset with a view to produce profit, it would be revenue expenditure.
3. *Integral part of profit earning*: If the outgoing is related to the carrying on or the conduct of the business, it may be regarded as an integral part of the profit earning process of operations, and not for acquisition of an asset of a permanent character, the possession of which is a condition precedent for the running of the business, then it would be expenditure of a revenue nature.
4. *Advantage for a limited period*: Special knowledge, or technical knowledge or a patent, or trade mark, is an asset if it may be acquired for payment for use and exploitation for a limited period. In this case what is required is not an asset or advantage of an enduring nature because at the end of the agreed period that advantage or asset reverts back intact to the giver of the special knowledge or the owner of the patents or trade marks. It would be expenditure of a revenue nature.
5. *Mode of payment is irrelevant*: If it is intrinsically a capital asset, it is immaterial whether the price for it is paid once for all, or periodically, or whether it is paid out of capital or income or linked up with net sales, the outgoing in such a case would be of the nature of capital expenditure.
6. *Payment in lump sum or Instalment is not significant*: If the amount paid for the acquisition of an asset of an enduring nature is settled, the mere fact that the amount so

settled is chalked out into various small amounts or periodic instalments, the capital nature of expenditure would not cease to be so or alter into the nature of a revenue expenditure.

7. *Liquidating recurring Claims:* A lump sum amount for liquidating recurring claims would not cease to be revenue expenditure or get converted into capital expenditure merely because its payment is spread over a number of years. It is the intention and object with which the asset is acquired that determines the nature of the expenditure incurred over it, and not the method or the manner in which the payment is made, or the source of such payment.
8. *Recurring:* If the expenditure is recurring and is incurred during the course of business or manufacture, it would be revenue expenditure
9. *Enduring nature does not mean permanent:* An asset or advantage of an enduring nature does not mean that it should last for ever. If the capital asset is in its nature a short-lived one, the expenditure for securing it must always be treated as capital expenditure.
10. *Stock-in-trade:* It is not the law that if an-enduring advantage is obtained, the expenditure for securing it must always be treated as capital expenditure if the advantage acquired is to get the stock-in-trade of the business, then it would be revenue expenditure.

These principles are exhaustive. They not only serve as guide to solve the problems that are before the court.

3.3 CAPITAL RECEIPTS

Capital Receipt is of non-recurring nature. Following are some of the examples:

1. Sale of assets of capital nature, e.g., land and buildings, plant and machinery, furniture and fixtures, etc.
2. Compensation received by one partner from another partner for relinquishing all his rights in the partnership. It may be of interest to know that the right of a partner in the partnership firm is a capital asset though it is not visible.
3. Compensation received for loss of right to future remuneration is capital in nature. For example, an employee is terminated from service and paid compensation of Rs.75,000 for loss of employment, it is capital nature. On the other hand, if the employee is paid a lumpsum of Rs.20,000 on the understanding that he will not claim salary for a period of three years the amount so received will be revenue in nature.
4. Compensation received for suspension of export licence.
5. Where foreign exchange is sent out of the country for purchase of a capital asset and due to change in the rate of exchange, there arises some profit, it would be capital receipt.
6. You might be aware of the term 'lease'. Lease means the right to make use of the asset

against lease rent. The asset is owned by a person which is given to the other for limited period, say, 20 years for use by the other person. The person so using the asset is expected to pay hire charges per month or per annum. These hire charges are known as lease rent. Lease rent is taxable in the hands of the lessor (owner of the asset)

There is a tradition to pay some lumpsum while negotiating the asset on lease. This lumpsum payment is known as 'Salami' or 'Nazrana'. The Salami or Nazrana so received by the lessor is capital receipt.

7. Amount realised from sale of trees with roots which were of spontaneous growth.
8. Entrance fees collected by a company in respect of new shares issued.

3.4 REVENUE RECEIPTS

Revenue receipt is of recurring nature. Following are some of the examples:

1. Hire charges of the capital asset.
2. Proceeds of sale of forest trees when they are cut at the stem and not with roots. There is a possibility of growth of the tree again.
3. The amount recovered by way of interest. Interest is the hire charges for use of money.
4. Lumpsum received for waiver of royalty.
5. Lumpsum received in consideration of reduction in remuneration. For example A is employed on a salary of Rs 5,000 per month. His employer asks him to accept a reduction in his salary from Rs 5,000 to 4,000. He agrees and by way of compensation for the reduction, he paid an amount of Rs.1,00,000. This amount is revenue receipt and is taxable.
6. Amount received as consideration for not resigning the directorship.
7. Compensation received for premature termination of contract.
8. Consideration received for transfer of permit.

Check your progress - 1

Determine whether the following are capital receipts or revenue receipts.

- i) Profit made from devaluation of Indian rupee.
 - ii) Premium on issue of shares.
 - iii) Compensation on account of compulsory vacation of business premises.
 - iv) Amount received on sale of business.
-

3.5 CAPITAL EXPENDITURE

Amount spent on acquiring or purchasing a capital asset is capital expenditure and is not allowed to be deducted from revenue receipts for calculation of taxable profit. Expenditure incurred to improve the condition or efficiency of capital asset is also capital expenditure. The following expenditures are capital in nature:

1. Expenditure incurred for purchase of furniture for the office.
2. Payment by a promoter, managing director to save the company in order to maintain his reputation as a promoter.
3. Acquisition by a publisher of copyrights. Now Section 35A provides for amortisation thereof.
4. Expenditure incurred in purchasing kennel for racing greyhounds.
5. Payment made for purchasing interest of another partner in the firm.
6. Amount spent for filling up the pit in the mill's leasehold premises.
7. Sums payable by a timber merchant under certain agreement to purchase standing timber without identifying the trees.
8. Acquisition by a cement manufacturer of a lease certain limestone quarries for a period of twenty years, on certain half yearly rent and royalties.
9. Amount spent in replacement of knives and lasts by a shoe and slipper manufacturer.
10. Amount advanced for purchase of shares in new company with the object of obtaining selling agency of its products.
11. Lumpsum payment to a person by way of inducement to joint service.
12. Acquisition of types, etc, by a printing press.
13. Hotel premises taken on lease for two years, erected shades, partitions and other temporary structures which were not to be removed on termination of the lease.
14. Expenditure incurred for fitting new windows to the factory building.
15. Amounts spent for reclaiming filling up the ditches, raising the plinth and construction of wall on a piece of land over which licence had been granted to the assessee to install a petrol pump by an oil distributing company.

16. Prospecting licence fees paid for working new mines.
17. Expenditure incurred by hotel, in the very first year of its existence on linen, blankets and uniforms for its employees.
18. Expenditure incurred by the assessee once for all for producing the benefit and use of M's services and payment there for to his former employer.
19. Expenditure incurred for erections of chimney by a brick-maker.
20. Payment for acquiring right, title and interest in lease in respect of the business premises.
21. Payment for acquiring the sole selling agency rights.
22. Expenditure incurred on construction of dams to prevent disaster and to ensure safety of workers and to protect the mines.
23. Assessee-company contributing Rs.50,000 to a Government hospital for purchase of equipment-as a result thereof, the assessee's employees not covered by the State Insurance Scheme, became entitled to the use of the hospital facilities-contribution held to be of capital nature.
24. Payment of betterment charges under a Town Planning Act.
25. Expenditure incurred in converting a ginning factory hall into a well-equipped cinema hall.
26. Purchase of machinery from foreign country-agreement for payment by instalments also providing for fluctuation in exchange rate excess paid in each instalment due to fluctuation.
27. Construction of workmen's quarters by the Government to be given on lease to the assessee-contribution towards.
28. Amount paid to the holding tenant by the assessee-lessor for getting vacant possession.
29. Expenditure on the replacement of the engines of the finishing boat by more powerful engines.

3.6 REVENUE EXPENDITURE

Expenses incurred on the purchase of goods for resale will be revenue expenditure. Similarly amount spent on keeping the asset in tact is revenue in nature. Expenses incurred in running the unit, salaries, wages, interest, electricity charges etc. are also revenue expenses.

1. Expenditure incurred with a view to resume business which had ceased to work.
2. Payment of annual sum by cinema proprietor for use of electric apparatus.
3. Expenditure by turf club on running school for training jockeys.

4. Expenses incurred for maintenance and upkeep of immature rubber-plants not yielding income in the relevant year.
5. Advance by a sugar-mill to sugar-cane growers, loss resulting from non-delivery of sugar-cane.
6. Expenditure by a lessee of cinema building in panelling i.e. fixing a thin layer of teak plywood on the walls, in order to cover up cracks and ugly spots thereon.
7. Expenditure by a coal owner company in carrying out stowing operations under the directions of the Department of Mines and proceeded depillaring operations, although the advantage gained therefrom may continue for a number of years in better extraction.
8. Interest paid under Section 34 of the Land Acquisition Act on delayed payment of the compensation for land acquired for business purposes through the Government.
9. Fees paid to an architect for revaluing the business for purposes of municipal value assessment.
10. Payment of an extra sum to the landlord in order to obtain lease of new business.
11. Expenditure incurred in connection with procurement of raw material.
12. Expenditure incurred in calling foreign technicians to examine the process of working the plant and suggesting improvement, which resulted in substantial rise in the production.
13. Expenditure incurred for repairing the roof of the factory premises.
14. Expenditure incurred on water supply scheme in consideration of exemption from municipal taxes for fifteen years.
15. Expenditure incurred by a tea-grower for fencing of the tea garden.
16. Admission fee for membership of East India Jute and Hessain Exchange Ltd.
17. Expenditure incurred for cutting the earth so as to reach the ore.
18. Assessee constructed house as per the scheme of the Coal Mines Labour Housing Board for employees-expenditure substantially reimbursed by the Housing Board-assessee had to incur excess expenditure to conform to specifications of the Board-excess expenditure held to be of revenue nature.
19. Amount spent on masonry construction on leasehold land as per the terms of the lease by a hotelier.
20. Expenses incurred by a hotelier for beautifying the hotel premises by putting decorated mirrors etc., or for petty replacement of certain items, such as worn-out things, fixing of plywood panels etc.

21. Expenditure incurred on a rented building for the renovation or alteration is, ordinarily, of revenue nature.
22. Contribution made to municipality towards repairs to the underground drainage pipelines in assessee's area.
23. Amount paid by a Jute mill for purchase of loom hours.
24. Any yearly payment by way of compensation for use and occupation of business premises even if it is intended to recoup the owner of his construction costs.
25. Sums paid for training of employees.
26. Replacement of transfer and service lines of a cold storage.
27. Expenditure by a newspaper concern in laying new cables for a change over from DC to AC current.
28. Amount paid to Electricity Board for laying new cables for increasing supply of electricity.
29. Contribution towards costs of erection of a primary health centre near factory premises.
30. Contribution to hospital for providing hospitalisation facilities to assessee's employees.
31. School building constructed and handed over to the municipality for the benefit of the children of the assessee's employees.
32. Replacement of certain old parts and thereby conversion of semi-automatic looms into automatic ones.
33. Expenditure incurred on installation of a hired machine where the owner reserved the right to remove.
34. Expenditure incurred by a bidi manufacture in replacing a petrol engine by a diesel engine in a truck used for business purposes.
35. Expenses incurred by a sugar manufacturer for improvement of the vacuum filter.
36. Expenses incurred in levelling the land for use as playground by the workers.
37. Expenditure incurred by the assessee in furnishing the employee's quarters as per the contractual obligations.
38. Cost of short lived tools and equipment, laboratory equipments and furniture and fixtures.
39. Fees paid for the survey of the imported machineries for ascertaining whether these were in accordance with the specifications or terms of the contract of purchase.

40. Payment made by the assessee under a compromise decree for maintaining sub-tenancy right irrespective of the business premises.
41. Expenditure incurred after manufacture of a product but before marketing it in order to test its suitability for marketing.
42. Expenditure on the replacement of ordinary lighting of florescent tubes.

Check your progress - 2

Determine the nature of following items.

- i) Brokerage paid for raising loan for the purpose of business.
- ii) Amount paid as commission to purchase machinery.
- iii) A sum paid by a partnership firm to an outgoing partner on the condition that he will not set up a competitive business in that area.

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3.7 ILLUSTRATIONS

1. State, giving reasons, whether the following are capital or revenue receipts:
 - (a) Compensation received for compulsory vacation of place of business.
 - (b) Bonus shares received by a dealer of shares.
 - (c) Money received by a Tyre Manufacturing Company for the sale to technical know-how regarding manufacturing of tyres.
 - (d) Dividends and interest from investment.

Solution

- (a) Compensation received for compulsory vacation of place of business will be capital in nature, though taxable under specific provisions of the Act. The amount has been received in lieu of source of earning.
- (b) Bonus shares received by a dealer of shares is a revenue receipt as it is incidental to his business.
- (c) Sale of technical know-how will be revenue in nature and, therefore taxable.

- (d) Dividends and interest from investment are revenue receipts.
2. State whether the following are capital or revenue receipts:

- (a) Compensation received for nationalisation.
- (b) Premium on issue of new shares.
- (c) Sales-tax collected from purchasers of goods.
- (d) Annuity.
- (e) Unclaimed dividend.

Solution

- (a) Compensation received for nationalisation, being the receipt in substitution of a source of income, is a capital receipt.
- (b) Premium on issue of new shares, being received from the shareholders is a part of capital and therefore, a capital receipt. Issue of shares is not the business of a company, but capital mobilisation from shareholders.
- (c) Sales-tax collected from purchasers of goods is not capital receipt. In a way the business collects it on behalf of the Government and pays. If it is considered a revenue receipt, then any sales-tax payable will also be allowed as revenue expenditure.
- (d) Annuities are the periodical receipts and generally considered as of revenue nature and, therefore taxable. But we must differentiate between an annuity by way of income and the receipt of capital amount in instalments. In the latter case it is not taxable.
- (e) Unclaimed dividend is not a receipt at all. It is neither the recoupment of an allowed loss nor remission of an allowed liability. Dividend distribution is not a revenue item and, therefore, the unclaimed dividend will not be revenue but of capital nature.

3.8 SUMMING UP

The concepts of capital and revenue are also very important because it is through the understanding of these terms that taxable income could be computed. Capital receipts are not taxable whereas revenue receipts are taken into account for computation of taxable income.

Similarly capital expenditure is kept out of the computation whereas revenue expenses are taken into account for calculating chargeable profit.

3.9 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Capital Receipt;
- ii) Capital Receipt;

- iii) Revenue Receipt;
 - iv) Capital Receipt
2. i) Revenue Expenditure
- ii) Capital Expenditure
 - iii) Capital Expenditure.

3.10. MODEL EXAMINATION QUESTIONS

I. ESSAY QUESTIONS

Answer the following in about 30 lines each:

1. How does the distinction between capital and revenue help us in computing taxable income. Describe with examples.
2. Explain whether the following are capital or revenue in nature. Give reasons.
 - (a) Misappropriation of cash by cashier.
 - (b) Loss of cash by theft in banking premises
 - (c) Bribe paid for evading octroi.
 - (d) Ganesh pooja expenses.
 - (e) Expenditure incurred by a surgeon on foreign tour to update his knowledge.
 - (f) Legal expenses in defending the title of business assets.

II. Short Questions

Answer the following in about 15 lines each :

1. Give ten examples of revenue expenditure.
2. Write ten items which will be capital in nature income and expenditure both.
3. Distinguish between capital expenditure and revenue expenditure.
4. Distinguish between capital receipts and revenue receipts.
5. What do you mean by capital receipts and revenue receipts?
6. What is the significance of differentiating between capital and revenue income?
7. State with reasons whether the following are capital or revenue nature :
 - (a) Payment made to the State Government for securing a transport permit.

- (b) Subscription to election fund of a political party.
- (c) Expenses incurred for erecting temporary structures.
- (d) Payment for acquisition of goodwill of a business.
- (e) Expenses incurred to fill up a pit where accumulation of waste water was creating a nuisance.
- (f) Payment made with a view to keeping the competitor out of your field of business.

UNIT - 4 : RESIDENTIAL STATUS

Contents

- 4.0 Aims and Objectives
- 4.1 Introduction
- 4.2 Determination of Residential Status
- 4.3 Individuals
- 4.4 Hindu Undivided Families
- 4.5 Firm or other Association of Persons
- 4.6 Companies
- 4.7 Illustrations
- 4.8 Summing up
- 4.9 Check Your Progress : Model Answers
- 4.10 Model Examination Questions.

4.0 AIMS AND OBJECTIVES

The objective of this unit is to familiarise you with the principles governing the determination of residential status of various assessees.

On completion of this unit, you should be able to :

- explain the determination of residential status of individuals;
- explain how the residential status of Hindu Undivided Families is decided;
- list out the rules governing the determination of residential status of Firms or Association of persons and Companies.

4.1 INTRODUCTION

The scope of taxability under the Income-Tax Act, 1961 depends on the residential status of the assessee. A person who does not stay here and who is a non-resident in India pays income-tax only in respect of the income that is received in India or earned in India. Residence is described in a typical way in the Act. It is neither domicile nor citizenship.

As the taxability of different incomes in the hands of an assessee depends upon his residential status in India during the previous year, the Income-Tax Act, 1961 classifies the assessees (Individuals and Hindu Undivided Families) into the following three categories:

(a) Resident and ordinarily resident:

(b) Resident but not ordinarily resident;

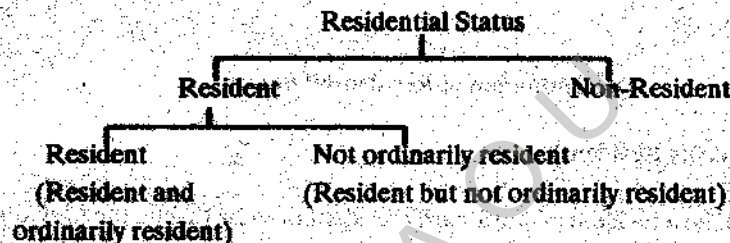
(c) Non-resident.

However, there are only two categories, viz., (a) Resident and (b) Non-resident in respect of other assesseees (Company, Firm, Association of Persons, etc.)

4.2 DETERMINATION OF RESIDENTIAL STATUS

Section 6 is relevant in this respect. It prescribes conditions for determining the residential status of individuals, hindu undivided families, firms, association of persons, companies, etc.

While determining the residential status of a person we have to first see whether the person is a resident or a non-resident. Once we have determined that a person is a resident, we will further see whether the person is ordinarily resident in India or is not ordinarily resident in India. The final picture will therefore emerge as follows:



4.3 INDIVIDUALS

For determining the residential status of any individual, section 6 is relevant. Section 6(1) contains two conditions for determining whether an individual is a resident or a non-resident. Sec.6(6) contains another set of two conditions for deciding further classification whether the individual would be ordinarily resident in India or not ordinarily resident. For the sake of simplicity we will call the first two conditions as 'basic' while those stated under section 6(6) would be termed 'additional'.

Basic Conditions [Sec.6(1)]

- (a) He must have been in India in that year for a period or periods aggregating in all to 182 days or more.

It is not necessary that the person must have stayed in India continuously for a period of 182 days or more. He may stay at a stretch or in intervals. He may stay in his own house, rented house or in a hotel. He may have stayed at one place or more than one place. It is interesting to learn that those who are moving out of the country have to get the passport, endorsed every time they come here or leave the country and therefore it is easy to find out how many days the person has stayed in India.

- (b) The person must have stayed in India for a period or periods aggregating in all to 365 days or more during four years preceding the previous year and for a period or periods aggregating in all to 60 days or more during the previous year.

Explanations

1. In case of an individual who is citizen of India and who leaves India during the previous year for employment outside India, he will have to stay here for a period of 182 days during the previous year in order to be classified as a resident.
2. On the other hand, where an individual who is a citizen of India and who has been outside India comes on a visit to India in any previous year, he will have to stay here for a period of 150 days or more during the previous year and not 60 days as stated in (b) above, in order to be classified as a resident in India.

Additional Conditions [Sec.6(6)]

- (a) He has been a resident in India (by complying with any of basic conditions) for 9 or more years out of 10 years preceding the previous year.
- (b) He has been physically present in India for a minimum of 730 days in 7 years preceding the previous year.

Determination of Residential Status

1. Resident (and ordinarily Resident)

An individual will be a resident and ordinarily resident in India during the previous year if he fulfils one or both the basic conditions and both additional conditions.

2. Not Ordinarily Resident

An individual fulfilling one or both the basic conditions and one or none of the additional conditions will be a not ordinarily resident in India during the previous year.

3. Non Resident

An individual who is not able to comply with any of the basic conditions will be a non-resident in India during the previous year. It does not matter whether he satisfies any or both of the additional conditions.

In case an individual wants not to enjoy the status of 'ordinarily' resident for tax reasons, he must remain non-resident here by remaining out of India for a period of two fiscal years. He will remain thus a not ordinarily resident until he completes a fresh period of nine years residence. He may once again remained absent for two years and thus he will be escaping the rigours of fiscal laws by keeping the status of not ordinarily resident throughout.

Examples

1. Ashok is an Indian citizen and for the first time left India for higher studies abroad on

15th October, 1991. What is his residential status?

Ashok has left the country for the first time on 15th October, 1991 for higher studies abroad. He has stayed in India in the previous year 1991-92 as stated below :

April	1991	30 days
May	1991	31 days
June	1991	30 days
July	1991	31 days
August	1991	31 days
September	1991	30 days
October	1991	14 days
Total		<u>197 days</u>

Basic Conditions

Since he has stayed in India for a period of more than 182 days during the previous year 1991-92 he satisfies one of two basic conditions.

Additional Conditions

As he has always been here till he left on 15-10-1991 he must have been a resident in India for 9 or more years out of ten years preceding the previous year. He satisfies the first additional condition.

Similarly as he has always been here, it is natural that he must have stayed for 730 days or more in seven years preceding the previous year.

Ashok therefore, satisfies one of the basic conditions and both the additional conditions and thus he will be a resident and ordinarily resident in India.

II. Assuming that Ashok leaves the country on 10th June 1991 explain his residential status.

Ashok has continuously stayed in India all these years since birth having never gone out of the country. During the previous year his stay is as under :

April	1991	30 days
May	1991	31 days
June	1991	9 days
Total		<u>70 days</u>

Basic Conditions

He does not stay in India for 182 days or more in the previous year 1991-92 and thus does not satisfy the first basic condition.

Coming to the second basic condition, the first part has been satisfied because he must have stayed in India for 365 days or more during the four years preceding the previous year. The second part of the condition envisages his stay here for 60 days or more during the previous year. As he has stayed in India for 70 days, the second basic condition with both parts has been satisfied.

Additional Conditions

All other things remaining the same, in this illustration too, Ashok will have satisfied both the additional conditions as follows:

1. He must have been a resident in India for 9 or more years out of ten years preceding the previous year.
2. He must have been in India for a period of 730 days or more during seven years preceding the previous year.

He is, therefore, a resident and ordinarily resident in India for the previous year 1991-92.

- III. Continuing the same problem, if Ashok leaves the country on 15th June, 1991 for employment outside India and not for higher education as stated above what is his residential status?

Basic Conditions

During the previous year 1991-92, Ashok has stayed in India for 75 days as given below :

April	1991	30 days
May	1991	31 days
June	1991	14 days
Total		<u>75 days</u>

Ashok therefore does not fulfil the first of the basic conditions which says that the individual must have stayed here for 182 days or more during the previous year.

According to explanation 1 (given above), the second condition will be complied with only when he stays in India during the previous year for a period of 182 days or more. In other words, for those who are leaving India for employment abroad, their stay in India for a period of 182 days or more is a must if they have to be classified as residents.

Ashok does not satisfy the second of the basic conditions either. Thus he will be non-resident for the previous year 1991-92.

Once he is not able to satisfy any of the basic conditions it is not necessary to see whether he fulfils the additional conditions or not.

- IV. Ashok left India on 15th June, 1988 for employment abroad and he visits here for a period of 75 days during the previous year. What is his residential status for the previous year 1991-92.

Basic Conditions

Ashok stays during the previous year 1991-92 for a period of 75 days only and thus he does not satisfy the first of the two basic conditions.

Coming to the second condition we find that he stays in India during four years preceding the previous year as follows:

1991-92	(previous year)
1990-91	Nil
1989-90	Nil
1988-89	75 days (30 + 31 + 14 days)
1987-88	365 days.
Total	<u>440 days</u>

Since he stays in India during the four years preceding the previous year for a period of 440 days, he fulfils the first part of the second condition. For the person who visits India having been outside India during the previous year he must have stayed here for a period of 150 days (according to Explanation 2) in order to satisfy the second part of the condition (b). Since he stayed here during the previous year 1991-92 for only a period of 75 days, he does not satisfy condition (b) too.

As Ashok does not satisfy any of the two basic conditions, he is a non-resident for the previous year 1991-92.

There is no necessity for further investigation to see whether he satisfies the additional two conditions or not.

Check your progress - 1

Mr. Rao, an Indian citizen, went to U.K on 10th October 1983 and returned after two years stay from there. Again on 10th June 1987 he went to U.S.A., but returned on 10th May 1991. He again went to Canada on 10th February 1992.

Find out his residential status for the Assessment Year 1992-93.

4.4 HINDU UNDIVIDED FAMILIES

Resident (Ordinarily Resident [6 (2)])

A hindu undivided family will be resident in India in any previous year where during the year the control and management of its affairs is situated in India wholly or partly. In addition, the manager has also to fulfil the additional conditions under section 6 (6) (b) described below :

- (a) The manager of the HUF has been a resident in India for 9 or more years out of 10 previous years preceding the previous year; and
- (b) He has been physically present in India for a period or periods aggregating in all to 730 days or more in 7 years preceding the previous year.

Not Ordinarily Resident

A hindu undivided family will be a not ordinarily resident in any previous year where during that year, through the control and management of its affairs is situated in India as above but the manager is fulfilling only one or none of the additional conditions.

Non-Resident

A hindu undivided family will be a non-resident in India where the control and management of its affairs is situated wholly outside India.

Explanation

In determining the residential status of a Hindu Undivided Family, the place of management and control of its affairs is important. The department has to see from where the affairs of the family are managed. It is not significant where the karta of the family is staying. What is not worthy is where exactly the manager of the family is, but from where he is managing the HUF. The Income Tax Act, 1961, uses the word 'manager' and not karta. It is therefore assumed that the manager of the family need not be the karta.

4.5 FIRM OR OTHER ASSOCIATION OF PERSONS [6 (2)]

Resident

A firm or other association of persons will be resident in India if the control and management of its affairs is situated in India wholly or partly.

Non-Resident

A firm or other association of persons will be a non-resident in India if the control and management of its affairs is situated wholly outside India.

Firm or other association of persons do not have the category of not ordinarily resident.

From the above you will notice that the firm will be resident in India even if a little of the control and management of its affairs is situated in India.

4.6 COMPANIES [6 (3)]

Resident

A company is said to be resident in India in any previous year in the following cases :

- (i) It is an Indian company, or
- (ii) During that year the control and management of its affairs is situated wholly in India.

Non-Resident

A company will be non-resident in India if it is neither an Indian company nor the control and management of its affairs is situated wholly in India.

Note: Companies are not classified as 'Not Ordinarily Resident'.

EVERY OTHER PERSON [6 (4)]

Resident

Every other person will be resident in India in any previous year where the control and management of its affairs is situated wholly or partly in India.

Non Resident

Every other person will be a non-resident in India in any year, where the control and management of its affairs is situated wholly outside India.

Check Your Progress - 2

ABC is a partnership firm registered in India and is controlled from India. Mr. A one of its partner was in USA for more than 340 days during the year ended on 31st March 1992 for business purposes. Determine its residential status for the previous year 1991-92.

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4.7 ILLUSTRATIONS

1. Amin is a citizen of India and a resident here. He proceeds to France for employment

there on 4th September, 1991 and is appointed there on a two year contract. State whether he would be a resident in India for the assessment year 1992-93.

Solution

From the details given it appears that Amin is an employee in India. It is therefore desirable that the financial year 1991-92 should be considered relevant in this case.

Since an Indian citizen is proceeding abroad for employment the condition of staying here for 182 days holds good in this case. He has left the country on 4th September 1991. His stay in India would be $(30+31+30+31+31+4)$ for a period of 156 days in the previous year. Since he is not satisfying the basic conditions, he is a non-resident in the previous year 1991-92.

2. Ranganath left for Canada on 20th March, 1989 after having lived for 25 years. He returned here on 15th September, 1991. Ascertain his residential status for the assessment year 1992-93.

Solution

He reached here on 15th September 1991 and stayed in India till 31st March 1992. He has thus lived in India for a period of 198 days during the year 1991-92.

Basic Conditions: He satisfies the first of the basic conditions in the sense that he has lived in India for a period of 182 days or more during the previous year.

Additional Conditions:

His residential status over ten years preceding the previous year will be as under:

1990-91	Did not stay	Non-resident
1989-90	Did not stay	Non-resident
1988-89	Stay for 353 days	Resident
1987-88	Stay for 365 days	Resident
1986-87	Stay for 365 days	Resident
1985-86	Stay for 365 days	Resident
1984-85	Stay for 365 days	Resident
1983-84	Stay for 365 days	Resident
1982-83	Stay for 365 days	Resident
1981-82	Stay for 365 days	Resident

In this case he is a resident in 8 out of ten years preceding the previous year. Thus he does not satisfy the first of the two additional conditions. We need not proceed to see whether he satisfies

the second condition.

By satisfying one of the basic conditions and only one of the additional conditions, Mr. Ranganath became a not ordinarily resident in India for the previous year 1991-92 relevant to the assessment year 1992-93.

3. Mr. Abbas Ali is an Indian citizen and is employed with a foreign shipping company with effect from 15th June, 1991 on a ten months contract. The contract period could be extended if the employer desires. If he comes back to India during last week of March, say, 25th March, 1992, determine his residential status.

Solution

Assuming that Mr. Abbas Ali has never moved out of the country earlier to 15th June, 1991 when he took up the employment, for the first time, we find that his stay in the previous year 1991-92 is as follows:

April	1991	30 days
May	1991	31 days
June	1991	14 days
March	1992	7 days
Total		<u>82 days</u>

Since Mr. Abbas Ali has taken up the employment outside India, he will be 'resident only' when he stays in India, during the previous year 1991-92 for a period of 182 days or more. As his total stay in India does not exceed 82 days, he will be a non-resident having not satisfied the condition prescribed for becoming a resident in India.

4. Mr. Chandrasekhar is the Karta of a HUF whose property etc. is situated in Pakistan. During the previous year 1991-92 he sent all his family members to India and stayed back there sending money to them in India for maintaining them. What is the residential status of the HUF?

Solution

The HUF will be a resident in India if the control and management of its affairs is situated in India partly or wholly. In this case we find that no part of the control and management of the Hindu undivided family existed in India. The karta was in Pakistan, the property is situated in Pakistan and naturally the control and management is located over there. The members of the family were in India just to live like this and from the information given in the question it is not clear that any of the members was associated with the control and management of the affairs of the family. The HUF is therefore a non-resident in India.

4.8 SUMMING UP

Total income of an assessee is based on his residential status. Section 6 of the Act lays down certain conditions for determining the residential status of different assessee. As per this section assessee are classified into three categories, i.e., Resident, Not Ordinarily Resident and Non-Resident. Individuals and Hindu undivided families can be residents or not ordinarily residents or non-residents. Other assessee like, Companies, Firms, Association of Persons can be either residents or non-residents but cannot be not ordinarily residents.

4.9 CHECK YOUR PROGRESS : MODEL ANSWERS

1. Residential status of Mr. Rao for the Previous Year 1-4-91 to 31-3-92 (Assessment year 1992-93).
 - i) Stay in India during the relevant previous year (10.5.91 to 9.2.92) = 276 days. He fulfils one of the basic conditions and hence is Resident.
 - ii) But he was not resident of India for 9 years out of 10 previous years preceding the relevant previous year, i.e. 1991-92 hence he is resident but not ordinarily resident.
2. It will be treated as resident in India for the previous year 1991-92 as its control and management is situated in India. It is immaterial whether any partner is resident or not during the year.

4.10 : MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following in about 30 lines each :

1. Discuss the rules that are applied to determine the residential status of an individual and a firm.
2. When is a Hindu Undivided Family resident and ordinarily resident in India?
3. Krishnakumar is an Indian citizen and has never been out of the country. He leaves India on 20th May 1991 and returned on 28th March, 1992. Determine the residential status of Krishna Kumar for the previous year 1991-92.
4. Professor Nityanand is appointed in the University of Baghdad and he leaves the country on 25th June, 1991 for taking up the assignment in Iraq on a three-year contract. He does not return till 31st March, 1992. Determine residential status of Professor Nityanand for the previous year 1991-92.

II. Short Questions

Answer the following in about 15 lines each :

1. Who is not ordinarily resident in India?

2. How do you decide the residential status of Hindu Undivided Family?
3. How would you decide whether an individual is resident and an ordinarily resident in India?
4. How do you decide the residential status of a company?

BRAOU

UNIT - 5 : INCIDENCE OF TAX

Contents

- 5.0 Aims and Objectives
- 5.1 Introduction
- 5.2 Scope of Total Income
- 5.3 Income Received
- 5.4 Income Deemed to be Received
- 5.5 Income Accruing or Arising
- 5.6 Income Deemed to Accrue or Arise in India
- 5.7 Illustrations
- 5.8 Summing Up
- 5.9 Check Your Progress : Model Answers
- 5.10 Model Examination Questions

5.0 AIMS AND OBJECTIVES

The objective of this unit is to discuss the scope of incidence of tax for all the three types of assessees.

After completing the unit, you should be able to :

- explain the scope of total income of three types of assessees, i.e. Resident, Not Ordinarily Resident and Non-Resident.
- discuss the taxability of income under different heads.
- explain income received and income deemed to be received.
- describe income accruing and income deemed to accrue in India.

5.1 INTRODUCTION

Having explained the conditions governing the determination of residential status of assessee, we will now discuss the incidence of tax. According to residential status assessee is of three types - residents, non-residents and not ordinarily residents. Similarly income is also classified on the basis of place of receipt and accrual. In this unit we will examine the relationship between the residential status and the place of receipt and accrual of income and taxability thereof.

This classification is the basis of determining the tax incidence in different cases. Section 5 is

titled as SCOPE OF TOTAL INCOME. It explains who will pay tax in respect of what.

5.2 SCOPE OF TOTAL INCOME

Resident [5 (1)]

Persons who are residents in India are charged income tax in respect of the following incomes:

1. Received or deemed to be received in India in the previous year by or on behalf of such person.
2. Accrues or arises or is deemed to accrue or arise to him during the previous year.
3. Accrues or arises to him outside India during the previous year.

Not Ordinarily Resident

Following incomes are taxable in the hands of persons who are not ordinarily residents in India.

1. Received or deemed to be received in India in the previous year by or on behalf of such persons.
2. Accrues or arises or is deemed to accrue or arise to him during the previous year.
3. Accrues or arises to him outside India during the previous year and derived from a business controlled in or a profession set up in India.

Non-Resident [5 (2)]

The incomes described below are charged to tax in the hands of persons who are non-residents:

1. Received or deemed to be received in India during previous year by or on behalf of such person.
2. Accrues or arises or is deemed to accrue or arise to him during the previous year.

Incidence of Tax Summarised

Sl. No.	Particulars of Income	To be taxed or not		
		Resident	Not-Ordinarily Resident	Non-Resident
1.	Income received or deemed to be received in India whether earned in India or elsewhere	Yes	Yes	Yes

2. Income earned in India during the previous year, whether received in India or elsewhere	Yes	Yes	Yes
3. Income earned and received outside India from a business controlled from India	Yes	Yes	No
4. Income earned and received outside India in the previous year from any other source	Yes	No	No
5. Income earned and received outside India during the years preceding the previous year and remitted to India during the previous year	No	No	No

Taxability of Income under different heads

Section 5 specified that income is taxable both on the basis of receipt and accrual. You will notice from the following units that the Income-Tax Act, 1961 classifies incomes under five heads. The description under those heads indicate whether income under a particular head is taxable on the basis of receipt or accrual. Accrual is also known as 'due' basis. Following is in brief the position of taxability of incomes under various heads --

Salaries

Salary for the current year is taxed on the basis of accrual.

Salary for the past year not accounted for then is taxed on the basis of receipt. For example, sometimes fixation of grades is done in the current year and the grades are made applicable retrospectively. The arrears so received are taxable in the current year.

Advance of salary received is also taxed on the basis of receipt.

Income from house property

Income from house property is also chargeable on the basis of accrual. However, if an increase in rent is effected retrospectively, the arrears so received will be taxed in the year of receipt though under different heads.

Profits and gains of Business and Profession

Profits and gains are chargeable on basis of method of accounting followed by the assessee.

If the assessee follows cash basis of accounting, profits will be taxed on the basis of receipt.

If the assessee follows mercantile system of accounting, the assessee will be asked to pay tax on the profits computed on the basis of accrual.

Capital gains

Section 45 is relevant in this case. It states that capital gains shall be deemed to be the income of the year in which the transfer took place. It is therefore based on the date of transfer and on the accrual basis.

Income from other sources

Dividends on the basis of declaration. Interim dividends on the basis of receipt. Annuity on the basis of accrual.

Interest on securities is chargeable on accrual basis. The date of actual receipt is not significant.

Commutation of annuity on the basis of receipt.

Hire charges of assets let out on hire would be taxed on the basis of method of accounting followed by the assessee.

DIFFERENT TYPES OF INCOMES ARE EXPLAINED BELOW :

5.3 INCOME RECEIVED

Income received in India during the previous year is taxable in the hands of all assesseees irrespective of their residential status. It is only the first receipt that is important, subsequent receipts have no significance. For example, some capital assets are held in Mauritius and proceeds received there. Subsequently the amount is remitted to India. Income, in this case, is received in Mauritius and not in India. Income may either be received in cash or cheque or by simple cross-entries. Receipt of income by agent or the bank holds good for Income-tax purposes.

5.4 INCOME DEEMED TO BE RECEIVED

These are the incomes which are not actually received but the law treats them as income received for income-tax purposes. This is treated on par with incomes received. In other words, whether income received in India or is deemed to be received in India, it is taxable here in the hands of all assesseees-resident, not ordinarily resident and non-resident.

Examples of Income Deemed to be Received

Sections 7 and 8 illustrate 'Income Deemed to be Received' as follows:

A. Annual Accretion [7(i)]

You might have heard about the provident funds. They are maintained by employers to which employee contributes something every month out of the salary he receives. Employer is also required to contribute a matching amount. The money so collected every month is invested in Government securities or in some other recognised investments. The investment then earns interest which also goes to the employee's account. The money so collected is paid back to the

employees when he retires from service or when he leaves employment. You will agree that the scheme of provident fund is a social welfare measure and therefore it would be proper if the amounts being contributed etc. remain tax free. Yes it is so.

Of the three components stated above, employer's contribution and the interest accruing to the employee's provident fund account is known as annual accretion. This annual accretion is generally tax free. But under certain circumstances a portion of annual accretion taxable is the deemed income. For details of provident funds you have to turn to the unit number 8.

B. Transferred Balance [7(ii)]

Transferred balance is the amount standing to the credit of the employee's account in un-recognised provident fund at the time of its conversion into recognised provident fund. This is taxed to the extent provided in the Fourth Schedule.

The amounts described under (A) and (B) above, though not received actually by the assessee are deemed to be received under the provisions of Section 7 of the Income-Tax Act, 1961.

C.Dividend [8(a)]

Any dividend declared by a company or distributed or paid by it within the meaning of Section 2(22) shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be.

D.Interim Dividend [8(b)]

Any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividends is unconditionally made available by the company to the member who is entitled to it.

You will remember one thing. Dividend is taxable in the year in which it is declared, whereas interim dividend is taxable in the year in which it is paid to the shareholder. There is a reason. Dividend is declared once it is approved by the annual general meeting of the shareholders. It cannot be undone. It has got to be paid to the shareholder after the annual general meeting. Payment is not significant and therefore it is taxed in the year in which it is declared. On the other hand interim dividend is declared only when the Board of Directors approve. There is no provision of getting it done by the meeting of the shareholders. The Board having declared it can also undo it.

5.5 INCOME ACCRUING OR ARISING

Chamber's Twentieth Century Dictionary defines the term 'accrue' as 'to come as on accession to fall due, to increase' and the term 'arise' as to 'rise up to originate, to come into being'. It may seem to convey the same meaning at first sight but in reality it is not so. Income accrues when it first comes into existence, it arises when the method of accounting shows it. Thus there may arise a situation when income accrues in one year, arises in the next, and received in the third. For example, rent of house property accrues every day but become payable only on the first of the next month. The tenant may pay the amount at any time he likes. Rent for the month of March, 1992

accrued at the close of 31st March, 1992 whereas it became due only the next morning, that, 1st April 1992.

TIME OF ACCRUAL - Some Illustrations

1. The right of a partner to receive the share of the profits of the firm for an accounting year arises on the settlement of accounts of the firm on the 1st date of the accounting year.
2. Profit on sale of a movable property will arise when the things are transferred whereas on the sale of an immovable property profit will arise on the registration of sale deed.
3. Where any agency is terminated and the agency contract stipulates payment of some compensation, it arises on the termination of the agency.
4. Commission on Insurance business becomes due and profit arises when the insurance agent books the policy with the company.
5. Underwriting commission will arise during the course when the subscription remained open, it will accrue when the company prepares the statement as regards the subscription of shares and finalises the accounts. It is on the finalisation of the accounts that the amount in fact becomes payable to various underwriters.
6. Exgratia payment become due or accrues only when it is paid. However, if the payer has made his decision to pay the exgratia amount, the amount will arise on the day when the decision to pay the exgratia communicated.

5.6 INCOME DEEMED TO ACCRUE OR ARISE IN INDIA

The following incomes are deemed to accrue or arise in India:

i) Income from Business Connection in India

All incomes arising directly through or from any business connection in India, property in India, any asset or source of income in India, or from transfer of any capital asset situated in India.

Where all operations of business are not carried out in India

There may be a situation where a few of the operations of a business activity are carried out in India and the remaining operations outside the country. For example, a publisher and a printer may print the books here and take them out of the country for binding and selling. He may argue that no income generates in India. In this case such part of the income as is reasonably attributable to the operations carried out in India (buying of paper and printing of the books) will be the income of the business deemed to accrue or arise in India.

Exports From India

A non-resident may have a business of buying things in India for exports and he will not run the risk of any income-tax, in this case no income from his business of exports will be deemed to

be the income accruing or arising in India.

Imports Into India (w.e.f. AY 1991-92)

So much of the income by way of royalty as consists of lump sum payment made by a resident for the transfer of all or any rights (including granting of licence) in respect of Computer Software supplied by a non-resident manufacturer along with Computer hardware under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India, shall not be deemed to accrue or arise in India.

Running a News Agency

Similarly a non resident may run a news agency and collect the news from India. But he will not be required to pay income-tax on the income attributable to the collection of news. All persons engaged in publication of newspapers, magazines, etc. and collecting news from India are not supposed to be earning any part of their income in India.

ii) Salaries

Income chargeable under the head 'Salaries' earned in India. For the removal of doubts it is stated that salaries payable for services rendered in India shall be regarded as income earned in India.

iii) Salaries payable Outside India

Income chargeable under the head 'Salaries' payable by the Government to a citizen of India for services rendered outside India.

iv) Dividends

Any dividend paid by an Indian company outside India.

v) Income From Interest

Interest payable by the Government or by a person resident in India or by a person who is non-resident where such interest is payable in respect of money borrowed or debt incurred for the purposes of a business or profession carried on by such persons in India or the purposes of making or earning any income from any sources in India.

vi) Income From Royalty

Income from royalty payable by the Government or a person resident in India or by a person non-resident in India where such royalty is payable in respect of any right, property of information used for services utilised for the purpose of a business or profession carried on by such person in India or for the purpose of making any income from any source in India.

vii) Fees For Technical Services

Income from fees for technical services payable by the Government or a person resident in India or by a non-resident where the fees payable in respect of services utilised in a business or

profession carried on by such person in India.

Check Your Progress - 1

The following are the incomes of Sri Krishna Rao for the previous year 1991-92

- i) Profit from business in Bombay-Rs. 14,000
- ii) Income accrued in india, but received in Italy Rs.12,000.
- iii) Profit from business in Germany, received in India - Rs.10,000.
- iv) Income from House Property in America, received in India - Rs.8,000.
- v) Profit from business established in Iran, the business being controlled from India Rs.6,000.
- vi) Income from House Property in Bangladesh and deposited in a bank there - Rs.4,000.
- vii) Past untaxed foreign income brought into India during the previous year - Rs.2,000.

Compute his total Income for the assessment year 1992-93 if he is : (i) Resident, (ii) Not - ordinarily resident (iii) Non-resident.

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Check Your Progress - 2

Mr.Sudeep, who is a resident but not ordinarily resident, received Rs.20,000 as remuneration for services rendered in U.K and credited in his bank account there and immediately thereafter remitted to India. Decide his taxability.

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5.7 ILLUSTRATIONS

1. Shri S.N.Sarma had the following incomes during the previous year ended under 31st March, 1992.

	Rs.
(a) Salary received in India for six months	15,000
(b) Income from house property in India	7,000
(c) Interest on Savings Bank Deposit in State Bank of India	3,000
(d) Amount brought into India out of the past untaxed profits earned in Germany	40,000
(e) Income from agriculture in Indonesia being invested there	32,350
(f) Income from a business in Burma being controlled from India	30,150
(g) Dividends received in Belgium from French Companies, out of which Rs. 35,000 were remitted to India	53,000

You are required to compute his total income, if Mr. Sarma is (a) a resident, (ii) not ordinarily resident, and (iii) a non-resident.

Solution

Computation of total income of Shri S.N. Sarma when he is a

	Resident	Not-Ordinarily Resident	Non-Resident
	Rs.	Rs.	Rs.
1. Salary received in India	15,000	15,000	15,000
2. Income from House Property in India	7,000	7,000	7,000
3. Interest on Savings Bank Deposit in State Bank of India	3,000	3,000	3,000
4. Amount brought into India out of past untaxed earnings	—	—	—
5. Income from agriculture in Indonesia	32,350	—	—

6.	Income from a business in Burma being controlled from India	30,150	30,150	—
7.	Dividends received in Belgium	53,000	—	—
	Total Income	1,40,500	55,150	25,000

2. Below are given the particulars furnished by Dr. Muniratnam, pertaining to the previous year 1991-92. You are required to calculate his total taxable income, if he is (a) a resident, (b) a not ordinarily resident (c) a non-resident.

	Rs.
1. Salary received in India	41,300
2. Payment received in U.S.A. for the services rendered in India	32,700
3. Served for two months in Indian Embassy situated in Lybia and Salary received there	44,000
4. Business profits earned in the past but remitted to India from Japan in the previous year	95,000
5. Income from cultivation of lands situated in Pakistan, remitted to India in the previous year	32,000
6. Interest received in respect of securities in German Companies	32,100

Solution

Computation of total income of Dr. Muniratnam when he is a –

	Resident	Not-Ordinarily Resident	Non-Resident
	Rs.	Rs.	Rs.
1. Salary received in India	41,300	41,300	41,300
2. Payment received in U.K. for service rendered in India	32,700	32,700	32,700

3. Service in Indian Embassy abroad	44,000	44,000	44,000
4. Past business profits remitted to India	—	—	—
5. Income from Pakistan	32,000	—	—
6. Interest in respect of securities in German Companies	32,100	—	—
Total	1,82,100	1,18,000	1,18,000

3. Following particulars of income have been submitted to you by Mr. Balasubramaniam for the previous year 1991-92. You are required to compute his total income chargeable to tax if Mr. Balasubramaniam is (a) resident (b) not ordinarily resident and (c) non-resident.

	Rs.
(a) Interest on fixed deposits in an Italian bank received there	50,000
(b) Income from house property situated in Indonesia received here	15,000
(c) Dividends received here from an Australian Company	7,500
(d) Salary received outside India for the services rendered in India	45,000
(e) Salary received in India for the services rendered in Burma	10,000
(f) Profit from a business controlled from India	89,000
(g) Profit from business situated in Iran	1,00,000

Solution

Computation of total income of Mr. Balasubramaniam when he is a —

	Resident	Not-Ordinarily Resident	Non-Resident
	Rs.	Rs.	Rs.
(a) Interest of fixed deposit in an Italian bank received there	50,000	—	—
(b) Income from house property situated in Indonesia received here	15,000	15,000	15,000
(c) Dividends received here from an Australian Company	7,500	7,500	7,500
(d) Salary received outside India for the services rendered in India	45,000	45,000	45,000
(e) Salary received in India for the services rendered in Burma	10,000	10,000	10,000
(f) Profit from a business controlled from India	89,000	89,000	—
(g) Profit from business situated in Iran	1,00,000	—	—
Total Income	3,16,500	1,66,500	77,500

5.8 SUMMING UP

Assesses are classified into three categories-residents, not ordinarily residents and non-residents. They will pay tax on incomes accruing and received in India or outside India. Income earned and received in India are chargeable in the hands of all assesseees whereas incomes earned and received outside India are taxed only in the hands of residents.

5.9 CHECK YOUR PROGRESS - MODEL ANSWERS

1. Computation of Total income of Sri Krishna Rao for the assessment year 1992-93.

Particulars	Resident	Not Ordinarily Resident	Non-Resident
I. Income received or deemed to be received in India:			
a) Profit from business in Germany but received in India	10,000	10,000	10,000
b) Income from house property in America but received in India	8,000	8,000	8,000
II. Income accruing in India:			
a) Profit from business in Bombay	14,000	14,000	14,000
b) Income accrued in India but received in Italy	12,000	12,000	12,000
III. Income accruing outside India and received outside India:			
a) Profit from business in Iran but controlled from India	6,000	6,000	Nil
b) Profit from house property in Bangladesh	4,000	Nil	Nil
IV. Past untaxed income brought into India during relevant previous year	Nil	Nil	Nil
Total Income	54,000	50,000	44,000

2. This income is accruing outside India and received outside India. Hence, fully exempted in this case.

5.10 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following in about 30 lines each :

1. Explain the income deemed to accrue or arise in India.
2. Give summary of the incidence of tax as per section 5 of the Income-Tax Act, 1961.
3. When are the following taxable?
 - (a) Salary
 - (b) Dividends
 - (c) Capital gains
 - (d) Income from house property
4. Following particulars are submitted by Mr. Ramakrishna for the previous year 1991-92. Describe the incidence of tax if Mr. Ramakrishna is a (a) resident (b) not ordinarily resident, and (c) non-resident.

	Rs.
(i) Capital gains on sale of assets in Germany	50,000
(ii) Pension received in India for the services rendered in Denmark	65,000
(iii) Agricultural income received from Pakistan	23,000
(iv) Salary earned in India but not received during the previous year	56,000
(v) Income from agriculture in Nepal not brought here	45,000
(vi) Profit from business in India	21,000

5. Compute the taxable income of Mr. Kulkarni when his residential status is (a) Resident (b) Not-ordinarily resident and (c) Non-Resident from the following particulars.
 - (i) Income accrued in Iran but received in India Rs. 15,000.
 - (ii) Rs. 30,000 were earned and received in Sri Lanka but brought later to India Rs. 20,000.
 - (iii) Rs. 18,000 earned and received in Dubai from a business controlled in India.

- (iv) Rs. 35,000 was earned from a business in U.K. but the profits have been remitted to India.
 - (v) Income from agriculture in Nepal not brought into India Rs. 65,000.
6. The following are the incomes of Shri Desai for the previous year 1991-92.
- (i) Profit from business in Dharward Rs. 7,000.
 - (ii) Income accrued in India but received in Italy Rs. 6,000.
 - (iii) Profit from business in England received in India Rs. 5,000.
 - (iv) Income from house property in Africa received in India Rs. 4,000.
 - (v) Profits from business established in Iran and deposited in a bank there, the business being controlled from India Rs. 3,000.
 - (vi) Income from house property in Pakistan and deposited in a bank there Rs. 2,000.
 - (vii) Past untaxed foreign income brought into India during the previous year Rs. 1,000. Compute the total income of Shri Desai for the assessment year 1992-93 if he is (a) Resident and (b) Non-resident.

II. Short Questions

Answer the following in about 15 lines each :

1. Explain the incomes that are chargeable in the hands of a not ordinarily resident.
2. Who will pay tax in respect of the following :
 - (a) Income received in India.
 - (b) Income earned in years preceding the previous year but remitted to India during the previous year.
 - (c) Income earned outside India but received in India.
 - (d) Income received outside India for the services rendered in India.
3. Explain Annual Accretion.
4. How are dividends taxed?
5. Relate incidence of tax with residential status of an assessee.
6. What are the incomes in respect of which a non-resident is required to pay tax?
7. What do you mean by the phrase 'Income received'?

BLOCK - II

EXEMPTIONS

This block discusses all the exempted incomes and other concessions available to assesseees under the Unit 'Exclusions'.

Unit - 6 : Exclusions

UNIT - 6 : EXCLUSIONS

Contents

- 6.0 Aims and objectives
- 6.1 Introduction
- 6.2 Exemptions at a Glance (Sec.10)
- 6.3 Exemptions Explained (Sec.10)
- 6.4 Exemptions under Sec.10 A and Sec.10 B
- 6.5 Rebatable Incomes under Sec.86
- 6.6 Exemptions under Sec.293 A
- 6.7 Summing Up
- 6.8 Check Your Progress : Model Answers
- 6.9 Model Examination Questions

6.0 AIMS AND OBJECTIVES

The objectives of this unit are to explain the incomes which remain outside the purview of income-tax and other concessions given to assesseees.

On completion of this unit, you should be able to :

- list out the incomes exempted from tax.
- explain some important exempted incomes.
- list out different rebatable incomes.

6.1 INTRODUCTION

As has been stated elsewhere, there are certain incomes that are tax free. In other words they are not included in total incomes or we may put it alternatively, saying that they remain outside the purview of the Income - Tax Act, 1961. They are discussed in Section 10 of the Act. The exemptions as per Section 10 can be grouped as below:

Certain Incomes Are Tax-Free

Tax exemptions are granted in respect of certain incomes for many reasons. Income like agricultural income cannot be taxed by the Central Government and therefore, it is tax free. Agriculture is a state subject and therefore the Central Government has no right under the constitution of India to tax it. As Hindu undivided family (HUF) itself is an assessee, a member of the HUF getting any income from it will not be required to pay tax. Then there are incomes like

travel concessions given by the employer, encashment of leave salary after retirement, payment from provident funds and similar amounts which are not taxed because the Government want the employees to be benefitted and are not put to hardship. Scholarship is not taxed as it will run counter to the purpose of scholarship.

Incomes accruing to certain authorities are tax free

It is not possible to tax all types of entities because once again the purpose will be lost. Can we or should we tax hospitals, educational institutions, municipal boards, panchayats, research associations, athletic associations, charitable trusts? The answer will be emphatically 'No'. We do not want these associations or institutions to be taxed because all of them are engaged not in making money but in making life of the citizens comfortable. They are doing some work which is for the welfare of the masses and therefore if we start taxing their activities, the tempo of the service rendered by these associations will come down and ultimately the society will suffer. The objective of our tax policy is not to harm the society but to increase social welfare. It is, therefore, necessary to state that such and such associations or institutions need not pay tax.

Incomes in the hands of non-citizens

You will agree and appreciate that foreigners who come as Ambassadors, High Commissioners and similar dignitaries should not be taxed. They come here as our guests and enjoy diplomatic status. Section 10 describes exemptions available to such high dignitaries. There is one more thing to be said in this connection. On a reciprocal basis our ambassadors in foreign countries are not taxed by those Governments. In international conventions reciprocity is important.

It is significant to note at this point that our employees who work in our embassies, high commissions and such offices are taxed here for the service rendered outside and paid for outside. As they stay outside India throughout the year they become non-residents and salaries earned outside India must not be taxed here. However, they are taxed in India under specific provisions.

Awards etc. are tax free

This is another area where we need to pay attention. You know awards are given by the institutions or governments for outstanding contribution by the person in literary, scientific or in some other fields. These awards also should not be taxed in the fitness of thing. Nobel Prize is a national pride for any person who gets it. Should we tax this prize and become an object of ridicule? No. The Act, therefore, makes an exemption of prizes, awards etc., for the imposition of income-tax.

We have earlier learnt that income-tax being a fiscal measure many types of concessions are made available in order to achieve desired objectives and goals. For example, if the government is interested in mobilising funds and investments, it gives concessions in respect of interest, dividends etc. On the other hand if it is felt that construction activities are to be strengthened, rental income could be made tax free. The tax measures thus offer a number of incentives. All such incentives would be discussed throughout the course wherever appropriate. However, in this unit we are covering all such concessions in order to give you an idea as to that the whole gamut of income-tax is about.

You will now concentrate on the chart appended at the end of the unit. Whatever incomes

you derive from whichever source, are grouped under the five heads viz., salaries, income from house property, profits and gains from business or profession, capital gains and income from other sources. Once gross incomes under those heads are known, permissible deductions are allowed therefrom. The resultant figures give you the net income under the respective heads.

From every head we must allow expenses to be deducted in order to arrive at the taxable income figure. Sometimes we allow deductions over and above the necessary expenses. This type of deduction is allowed to help the assessee to reduce his tax liability because the government desires to give concessions in the desired fields. For example, if the government is interested in scientific research and development, the Act might include a provision that all expenses pertaining to scientific research whether related to business or not would be allowed to be deducted from business income. In this way all those who are undertaking scientific research and spending large amounts thereon would be encouraged to spend more and more thereon. Similarly if the government is interested in construction of houses, it may provide for a deduction of some amount out of the rent collected so that the resultant taxable income from house property is reduced.

While explaining deduction under various heads we will categorise them broadly under two heads, namely, deduction for expenditure and deduction by way of incentives. It may, however, be emphasised here that Income-Tax Act does not define the deductions in this way. The said classification will give you a fair idea as to why a particular deduction is permissible. Secondly, the deductions which are stated in this unit are exhaustively dealt with because they will once again be discussed in proper context.

In addition to the above, exemptions under Sec. 10A and Sec. 10B applicable to newly established undertakings are provided. Details are given at the end of this unit.

Certain incomes are included in total income but they are exempted from income tax at the average rate of tax applicable to the total income. Details of rebatable incomes under Sec. 86 are given at the end of this unit.

Participation in business of prospecting mineral oils will become eligible for getting exemption under Sec. 293A. The details are given at the end of this unit.

6.2 EXEMPTIONS AT A GLANCE (SEC. 10)

A. Certain Incomes are Tax Free

1. Agricultural Income, Section 10(1).
2. Sums received from H.U.F., Section 10(2).
3. Casual and non-recurring receipts, Section 10(3).
4. Travel Concession, Sec. 10(5).
5. Perquisites outside India, Sec. 10(7).
6. Income Under Co-operative Technical Assistance Programme, Section 10(8).

7. Income of any member of the family of an individual referred to in Section 10 (8), Section 10 (9).
8. Death cum retirement gratuity, Section 10 (10).
9. Commutation of pension, Sec. 10 (10-A).
- 9-A. Encashment of leave salary after retirement, Section 10 (10-AA).
10. Compensation on Retrenchment, Section 10 (10B).
11. Payment on voluntary retirement, Section 10 (10 C).
12. Payment from Statutory and Public Provident Funds, Section 10 (11).
13. Payment from Recognised Provident Fund, Section 10 (12).
14. Payment from Approved Superannuation Fund, Section 10 (13).
15. House Rent Allowance, Section 10 (13A).
16. Special Allowance for meeting business expenditure, Section 10 (14).
17. Exchange Risk Premium received by Public financial institution, Section 10 (14A).
18. Interest on certain Securities and Deposits, Section 10 (15).

According to Section 10 (15) of the Act, interest on the undernoted securities does not form part of total income of any assessee and they are, therefore, not taken into account while computing total income. They are tax-free in the hands of all assessees.

- (i) Monthly payment on the 15 days Annuity Certificates issued by the Central Government.
- (i) (a) Premium on the redemption of Special Bearer Bonds, 1991.
- (ii) (a) Treasury Saving Deposit Certificates
- (b) Post Office Cash certificates
- (c) Post Office National Saving Certificates
- (d) National Plan Certificates
- (e) 12 Year National Plan Certificates
- (f) Interest on deposits on Post Office Savings Bank
- (g) Bonus in respect of deposits under the Post Office Savings Bank (Cumulative Time Deposits Rule, 1959).
- (h) 10 year Defence Deposit Certificates.

- (i) 12 Year National Defence Certificates.
- (j) The Government of India Defence Certificates.
- (k) 7 year National Savings Certificates (II issue).
- (l) 7 year National Savings Certificates (II issue) - Bank Series.
- (m) 7 year National Savings Certificates (III issue).
- (n) 7 year National Savings Certificates (III issue) Bank Series.
- (ii) (a) Interest on fixed deposits under any scheme framed by the Central Government and notified by it in this behalf in the Official Gazette:

The following schemes have been notified by the Government in official gazette:

- (a) The Government Saving Certificates (Fixed Deposits) Rules, 1968.
- (b) The Post Office (Fixed Deposits) Rules, 1951.
- (ii) (b) Interest on 7% Capital Investment Bonds issued by the Government of India. These bonds are repayable on the expiration of ten years. This benefit is available to individuals and HUF only.
- (iii) Interest on securities held by the Issue Department of the Central Bank of Ceylon.
- (iv) (a) Interest on loans taken by the Government of local authority from sources outside India.
- (b) Interest on borrowings by industrial undertakings in India under a loan agreement entered into with some financial institution in a foreign country subject to its being approved by the Central Government.
- (c) Interest on amount borrowed and debit incurred by an industrial undertaking in respect of raw material, plant or machinery purchased outside India subject to the rate being approved by the Central Government.
- (d) Interest paid by Industrial Finance Corporation of India, Industrial Development Bank of India, Industrial Credit and Investment Corporation of India on borrowings outside India subject to the rate being approved by the Government of India.
- (e) Interest on borrowings by any other financial institution or a banking company subject to the rate of interest being approved by the Central Government.
- (f) Interest payable by an industrial undertaking in India on any moneys borrowed by it in foreign currency from sources outside India under a loan agreement approved by the Central Government.

- (v) Interest on securities held by the Registrar, Supreme Court in the Reserve Bank's SGL A/C.
- 19. Payment by Indian company for acquisition of aircraft on lease from foreign Government / company, Section 10 (15A).
- 20. Scholarship, Section 10 (16).
- 21. Annual Value of one palace, Section 10 (19 A).
- 22. Subsidy from or through Tea Board etc., Section 10 (30).
- 23. Subsidy from Rubber, Coffee or Spices Board, Sec. 10 (31).

B. Income Accruing to certain authorities are Tax-Free

- 1. Certain income of a local authority, Section 10 (2).
- 2. Income of any authority doing town planning etc., Section 10 (20A).
- 3. Income of a scientific research association, Section 10 (21).
- 4. Income of an educational institution, Section 10 (22).
- 5. Income of a hospital, Section 10 (22A).
- 6. Income of an athletic association, Section 10 (23).
- 7. Income of professional associations, Section 10 (23 A).
- 8. Income of any Regimental Fund of the Armed Forces, Sections 10 (23 AA).
- 9. Income of Khadi and Village Industries, Section 10 (23B).
- 10. Income of Khadi and Village Industries Board, Section 10 (23 BB).
- 11. Income of any statutory authority engaged in public religious activities, Section 10 (23 BBA).
- 12. Income of specified charitable trust etc., Sec. 10 (23 C).
- 13. Income of Mutual Fund, Section 10 (23 D).
- 14. Income of Exchange Risk Administration Fund, Section 10 (23 E).
- 15. Income of a registered trade union, Sec. 10 (24).
- 16. Income accruing to Provident Funds, Sec. 10 (25).
- 17. Income of a corporation established by Government, Sec. 10 (26 B).
- 18. Income of an authority for letting of godown etc., Sec. 10 (29).

C. Incomes in the hands of Non-citizens are tax free

1. Remuneration received for shooting of a cinematograph film in India, Sec. 10 (5 A)
2. Passage money, Sec. 10 (6) (i).
3. Remuneration received by Ambassador and such dignitaries, Sec. 10 (6) (ii).
4. Remuneration received by an employee of a foreign enterprise, Sec. 10 (6) (vi).
5. Remuneration received from foreign philanthropic institution, Sec. 10 (6) (vi a).
6. Income in the hands of a technician, Sec. 10 (6) (vii a).
7. Employment on a foreign ship, Sec. 10 (6) (viii).
8. Employment as a professor, Sec. 10 (6) (ix).
9. Employment for research, Sec. 10 (6) (x).
10. Remuneration in training, Sec. 10 (6) (xi).

D. Awards etc. are Tax free

1. Literary, scientific and artistic work awards, Sec. 10 (17A).
2. Other rewards by Government, Sec. 10 (17B).
3. Ex-gratia payments to foreign rulers, Sec. 10 (18A)

E. Incomes in the hands of a non-resident are tax free

1. Interest in the hands of a non-resident from specified securities, Sec. 10 (4).
2. Interest accruing to Non-Resident External Account, Sec 10 (4A).
3. Interest on Savings Certificate in the hands on non-resident, Sec. 10 (4B).
4. Fees for technical services received by a foreign company, Section 10 (6A).
5. Tax paid by a Government or an Indian concern on behalf of a non resident or a foreign company, Sec. 10 (6B).
6. Income of foreign company by way of fees for technical services, Section 10 (6C).

F. Other Groups

1. Daily allowance to M.Ps and M.L.As., Sec. 10 (17).
2. Income of Scheduled Tribe, Sec. 10 (26).
3. Tax Credit Certificates, Sec. 10 (28).

G. Tax holiday in respect of Free Trade Zones, etc.

1. Special provision in respect of newly established industrial undertakings in Free Trade Zones (10A).
2. Special provision in respect of newly established 100 percent export - oriented undertakings (10 B).

6.3 EXEMPTIONS EXPLAINED (SEC. 10)

1. Agricultural Income

It has already been discussed in Unit 2.

2. Sums Received by the Member from Hindu Undivided Family

Any sum received by an individual as a member of a Hindu Undivided Family where such sum has been paid out of the income of the family is exempt from tax. The idea here is that the hindu undivided family is an assessable entity itself and, therefore, any amount received by the member from his H.U.F. must not be taxed again.

3. Casual and Non-Recurring Receipts

A casual receipt resembles a windfall received without any prior calculation, expectation or effort. The following are the casual receipts:

- (a) gifts received on occasions like birthday, marriage anniversary or other similar celebrations.
- (b) gifts received as a result of admiration for personal qualities of the recipient for service to the community or country.
- (c) incomes received from winnings from crossword puzzles, card games or any kind of gambling, betting including winnings from lotteries.
- (d) Winnings from races including horse races.

As far as taxability of the casual receipts is concerned, the receipts falling under (a) and (b) above are wholly exempt, while the income falling under (c) is exempt to the maximum extent of Rs. 5,000 in aggregate. The income falling under (d) is exempt upto Rs. 2,500.

The following receipts are all chargeable to tax even if they are casual and non-recurring nature:

- a) Capital gains chargeable under section 45.
- b) Receipts arising from business, profession or occupation.
- c) Receipts by way of addition to the remuneration of an employee.

The wording of the section suggests that any casual receipt from trade or from an adventure

in the nature of trade should be regarded as income and assessed to tax.

4. Interest in the hands of a non-resident

The following interest will be exempted:

- a) Interest on notified Government securities.
- b) Interest on moneys standing to credit in a Non-Resident (External) Account in India in accordance with the FERA, 1973.
- c) Interest from savings certificates.

The benefit of exemption has been extended to such persons also who have been permitted by the Reserve Bank of India to maintain a Non-Resident (External) Account in any bank in India (w.e.f. AY 1991-92).

5. Travel Concession: See unit 7.

5A. Income from Shooting of Cinematograph Film in India

In the case of an individual who is not a citizen of India and is non-resident, who comes to India solely in connection with the shooting of cinematograph film in India by the individual, firm or company any remuneration received by him for rendering any service in connection with such shooting is exempt.

6. Income in the hands of an individual who is not a Citizen of India

The following incomes shall be exempt:

- (i) Passage moneys or the value of any free or concessional passage received by, or due to such individual from his employer for himself, his spouse and children in connection with his proceeding on home leave out of India.
- (i-A) Passage money received from his employer for his children having full-time education in any educational institution outside India in connection with their proceeding to India during vacation.
- (ii) Remuneration received by him as ambassador, High Commissioner, envoy, minister, charge 'd' affairs, commissioner, counsellor, or the secretary, adviser of attache of an embassy, high commission, legation or commission of a foreign State. [See 10 (6) (ii)]
- (iii) Remuneration received by him as a counsel de carrier of a foreign State.
- (iv) Remuneration received by him as a Trade Commissioner, or other official representative in India of the Government of a foreign State on reciprocal basis.
- (v) Remuneration received by him as a member of staff of any of the official referred to in (ii), (iii) and (iv) above. He must also fulfil the following conditions:

- (a) He is a subject of the country represented by him.
- (b) He is not otherwise engaged in any business or profession or employment in India.
- (c) In case he is a member of the staff of the official referred to in (iv), then reciprocal exemption must be available to the members of the staff of the corresponding officials of our Government.
- (vi) Remuneration received by an employee of a foreign enterprise for services rendered by him in India provided the following conditions are fulfilled [See 10 (6) (vi)].
 - (a) The foreign enterprise is not engaged in any trade or business in India.
 - (b) His stay in India does not exceed in the aggregated period of 90 days in the previous year.
 - (c) Such remuneration is not to be deducted from income of the employer chargeable under this Act.

(vi-a) Remuneration received from Foreign Philanthropic institutions [See 10 (6) (vi a)]

Remuneration received by him as an employee of or a consultant to an institution etc., formed outside India, solely for philanthropic purposes for services rendered in India in connection with such purpose. There is a condition that such institutions and the purposes etc., must be approved by the Central Government.

(vii) Income in the hands of a technician employed after 31-3-1971: [See 10 (6) (vii a)]

Remuneration received by the technician employed after 31-3-1971 by the Government, local authority, corporation set up under any special law an institution or body established in India for carrying on approved scientific research or by any business in India shall be exempt provided the following conditions are fulfilled:

- (a) The individual was not resident in India in any of the four financial years in which he arrived in India.
- (b) He was not a citizen of India.
- (c) The contract of his service in India is approved by the Central Government. The application for such approval must be made to the Government before the commencement of such service or within six months of such commencement. However, this approval is not necessary w.e.f. 1-6-1992.

The limit of exemption under this clause is as follows:

1. For a period of 24 months from the date of his arrival in India subject to a maximum of Rs. 4,000 per month. Where the salary paid exceeds the said limit and the income-tax is payable by the employer, the tax so paid by the employer will also be tax-free.

2. Where technician continues to remain in employment in India after the expiry of 24 months with the approval of the Central Government obtained before 1st October of the relevant assessment year and where the tax is paid on his salary by the employer, the tax so paid by the employer for a period not exceeding 24 months next following the expiry of the first mentioned 24 months shall be tax free. Tax-free salary will be allowed to be paid in such cases notwithstanding the prohibition contained in Section 200 of the Companies Act, 1956 prohibiting payment of tax-free salary to an employee.

"Technician" for the purpose of this sub-clause will mean a person who has specialised knowledge and experience in the following:

- (a) Constructional or manufacturing operations or in mining or in the generation of electricity or any other form of power : or
- (b) Agricultural, animal husbandry, dairy farming, deep sea fishing or ship building:
- (c) Such other fields as the Central Government may having regard to the availability of Indians having specialised knowledge and experience therein, the needs of the Country and other relevant circumstances, by notification in the Official Gazette, specify.

The Finance Act, 1988 effective from Assessment year 1989-90 has abolished the above exemption where the service of technician commences on or after 31st March, 1988.

- (viii) Employment on a foreign Ship [See 10 (6) (viii)]

Income chargeable under the head "salaries" received by or due to a non-resident individual for services rendered in connection with his employment on a foreign ship where his total stay in India does not exceed a period of 90 days in the previous year.

- (ix) Employment as a Professor or Other Teacher [See 10 (6) (ix)]

Income chargeable under head the "salaries" received by or due to him during 36 months from his arrival in India for services rendered as a professor or other teacher in university or other educational institution. Where he continues after the said period and where the tax on his salary is paid by the University or other educational institution the tax so paid for a period of 24 months shall be exempt from the tax. The exemption under this sub-clause is subject to the following conditions:

- 1. Such individual was not resident in any of the four financial years immediately preceding the financial year in which he arrived in India.
- 2. His contract of service is approved by the Central Government on or before 1-10-1964, where the service commenced before 1-4-1964. In case the service commenced after 1-10-1964, the contract must be approved by the Central Government within one year of the commencement of services.

(x) **Employment for Research [Sec 10 (6) (x)]**

Any sum due to or received by him during 24 months from the date of his arrival in India for undertaking any research work provided the following conditions are fulfilled.

1. The research work is undertaken in connection with a research scheme approved by the Central Government on or before 1st October of the assessment year.
2. The amount is payable or paid directly or indirectly by the Government of a foreign State or any institution or association or other body established outside India.

(xi) **Remuneration received by Officers of foreign Governments from their respective Governments during the period of training in India in the Public Sector.**

6-A. Fees for Technical Services Received by a foreign Company

Where income is derived by a foreign company by way of royalty or fees for technical services and tax on such income is payable by the Indian party, the tax so paid will not be included in computing the total income of the foreign company. The necessary conditions to be complied with in this connection are as follows:

- (a) The agreement made by the foreign company with Government or the Indian concern will be after 31-3-1976.
- (b) The agreement so entered into will be approved by the Government of India.
- (c) Tax on such income payable by the Indian party is according to the terms of agreement.

As per the Finance Act, 1992, the approval of the agreement by the Central Government is not necessary where such agreement is in accordance with the Industrial Policy of the Government of India. This is applicable w.e.f. 1st June, 1992.

Note: It is interesting to learn at this stage that if the payer wants to discharge the tax liability of the receiver in respect of salary or remuneration, it can be done but the tax so paid will be taken to be the deemed income of the recipient. For example if X pays Y a salary of Rs. 20,000 and also he undertakes to discharge the tax liability of Y he will calculate income-tax on Rs. 20,000 which will be Rs. 1,125. If the employer pays this amount the total income of Y will be taken to be Rs. 21,125 (20,000 + 1,125). In other words the tax liability discharged by the employer will be the deemed income of the employee and he will be assessed on the income plus the tax liability so discharged by the employer. The tax so paid by the employer will not be taken to be the deemed income of the assessee, if the Government permits such payment. Section 10 (6-A) stipulates that the foreign party could be paid remuneration and with the approval of the Government of India, tax liability of the foreign company could be discharged by the Indian party and tax so paid will not be taken to be the deemed income of the foreign company while taxing its income.

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6-B. Tax Paid by Government or Indian Concern:

The Finance Act, 1988 stipulates that from the Assessment year 1989-90, the amount of tax paid by government or an Indian concern on behalf of a non-resident or a foreign company in respect of its income (not being salary, royalty or fees for technical services) will not be included in computing the total income of such non-resident or foreign company. However, the following conditions are to be satisfied:

- (a) The income should arise in pursuance of an agreement entered between the Central Government and the government of a foreign state: and
- (b) The tax is paid as per the agreement approved by Central Government.

6-C. Income of foreign company by way of fees for technical services:

As per Direct Tax Laws (Amendment) Act, 1989, where any foreign company derives any income, by way of fees, for providing services in projects connected with security of India, the same will exempt.

7. Perquisites etc. Outside India.

Any allowance or perquisite paid or allowed as such outside India by the Government to a citizen of India for rendering service out side India.

8. Co-operation Technical Assistance Programme

In the case of an individual who is assigned duties in India in connection with co-operative technical assistance programmes and projects in accordance with an agreement entered into by the Central Government and the Government of a foreign state, the following income shall be exempt:

- (a) The remuneration received by him directly or indirectly from the Government of that foreign State for such duties: and
- (b) any other income of such individual, which accrues or arises outside India and is not deemed to accrue or arise in India in respect of which such individual is required to pay any income or social security tax to the Government of that foreign State.

8A. Remuneration Of A Consultant (w.e.f. AY 1991-92)

Any remuneration or fee received by a consultant, directly or indirectly, out of the funds made available to an international organisation (called as Agency) under a technical assistance grant agreement between that agency and the Government of a foreign State shall be exempt; provided that such person is engaged by the agency for rendering technical services in India in accordance with an agreement entered into by the Central Government and the said agency and the agreement relating to engagement of the consultant is approved by the prescribed authority.

Here 'Consultant' means any individual who is either not a citizen of India or being citizen of India, is not ordinarily resident in India or any other person who is a non-resident.

8B. Remuneration of an employee of the Consultant (w.e.f. AY 1991-92)

The remuneration received by an employee of the consultant mentioned in Section 10 (8A) shall be exempt provided that:

- i) such employee is either not a citizen of India, or being a citizen of India, is not ordinarily resident in India;
- ii) the contract of service is approved by the prescribed authority before the commencement of his service.

9. Income of any Member of the Family [Sec. 10 (9)]

The income of any member of the family or any such individual as is referred to in clause (8) accompanying him to India, which accrues or arises outside India and is not deemed to accrue or arise in India in respect of which such member is required to pay any income or social security tax to the Government of the foreign State.

Enlargement of scope of Section 10 (9) (w.e.f. AY 1991-92).

The income of any member of the family of any such individual as is referred to in section 10 (8A) or 10 (8B) accompanying him to India, which accrues or arises outside India, and is not deemed to accrue or arise in India, in respect of which such member is required to pay any income-tax or social security tax to the country or origin of such member, shall be exempt.

10. Death-cum Retirement Gratuity

10A. Commutation of pension.

10AA. Encashment of Leave after retirement.

10B. Compensation for Retirement.

For an explanation of items 10 to 10B, please refer to unit 7.

10BB. Compensation received by victims of Bhopal Gas Leak Disaster:

Compensation received by victims under the provisions of Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985 will be exempt from tax - with effect from AY 1992-93.

However, compensation received by an assessee in respect of an expenditure which has been incurred and allowed as a deduction from taxable income will not be exempt from income tax.

10C. Payment received by an employee of a public sector undertaking on his voluntary retirement.

10D. Life Insurance money (w.e.f. AY 1991-92)

Any sum received under a life insurance policy including bonus shall be exempt.

11. Payment from Statutory Provident Fund.

12. Payment from Recognised Provident Fund.

13. Payment from Approved Superannuation Fund.

13A. House Rent Allowance.

14. Special Allowance for meeting business expenditure.

For an explanation of Items 10C to 14, please refer to Unit 7.

14A. Exchange Risk Premium:

As per Finance Act, 1989, w.e.f. Assessment year 1989-90, where any public institution receives any exchange risk premium from any person borrowing foreign currency from it, the same will be exempt provided the premium is credited to the Exchange Risk Administration Fund.

15. Interest on certain securities and deposits.

- a) Interest on money borrowed by the National Housing Bank from sources outside India shall not form part of the total income of the lender to the extent it does not exceed the amount of interest calculated at the rate approved by the Central Government. (w.e.f. AY 1991-92).
- b) Interest on deposit with a Scheduled bank in foreign currency shall be exempt where the acceptance of such deposits by the bank is approved by the Reserve Bank of India. (w.e.f. AY 1991-92).

15A. Payment of Lease Rent

Any payment made by an Indian Company engaged in the business of operation of air craft (Air India and Indian Airlines) to acquire an aircraft on lease from the Government of a foreign State or a foreign enterprise (non-resident in India under an agreement approved by the Central Government in this behalf).

16. Scholarships:

Scholarship granted to meet the cost of education.

17. Daily Allowance to MPs. and M.L.As.

- (i) Any income by way of daily allowance received by any person by reason of his membership of parliament or of any State Legislature or any committee thereof.
- (ii) Any allowance received by any person by reason of his membership of Parliament under the Members of Parliament (Constituency Allowance) Rules, 1986.
- (iii) All other allowances not exceeding Rs. 600 per month in the aggregate received by any person by reason of his membership of any State Legislature or of any Committee thereof. It is necessary in this regard that the Central Government will have notified in the Official Gazette such exemption.

17A. Literary, Scientific and Artistic Work Awards

Any payment made whether in cash or kind, in pursuance of awards for literary, scientific and artistic work of attainment or for proficiency in sports and games is exempted. The only other condition is that such award must be approved by the Central Government. Prize received for services for alleviating the distress of the poor, weak and ailing is also tax-free.

17B. Other Rewards by the Government

Any payment made, whether in cash or kind as a reward by the Central Government or any State Government for such purpose as may be approved by the Central Government, in this behalf in the public interest.

18A. Ex-gratia Payment

Any ex-gratia payment made by the Central Government consequent on the abolition of privy purses.

19A. Annual value of one palace

The annual value of any one palace in the occupation of a Ruler, being a palace, the annual value thereof was exempt from income tax before the commencement of the Constitution (Twenty Sixth Amendment) Act, 1971.

20. Income of a local authority

The income of a local authority which is chargeable under the heads "Income from the House Property", "Capital gains" or "Income from other sources" or from a trade or business carried on by it, which accrues or arises from supply of a commodity or service (not being water or electricity) within its jurisdictional area or from supply of water or electricity within or outside its own jurisdictional area.

20A. Income of an authority

Any income of an authority constituted in India by or under any law enacted either 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 and villages or for both.

21. Income of Scientific Research Association

Any income of a scientific research association approved under Sec. 35 (1) (ii) is exempt from tax subject to the fulfilment of the following conditions:

- a) It has to apply its income or accumulate it for application wholly and exclusively to the objects for which it is established.
- b) It has invested / deposited its funds for any period during the previous year in the specified manner.
- c) Exemption will not be available in respect of any income of such association being profits

and gains of business unless the business is incidental to the attainment of its objectives.

22. Income of an Educational Institution.

Income of a University or other educational institution, existing solely for educational purpose and not for purposes of profit.

22A. Income of a Hospital

Income of a hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit.

23. Income of an Athletic Association

Income of an association or institution established in India having as its object the control, supervision, regulation or encouragement in India of the games of cricket, hockey, football, tennis or such other games or sports, Central Government may specify in this behalf from time to time by notification in the Official Gazette. But the following conditions must be fulfilled:

- (i) The association or institution applies its income, or accumulates it for application solely to the objects for which it is established;
- (ii) No part of the income of the association or institution is distributed in any manner to its members except as grants to any association or institution affiliated to it;
- (iii) The association or institution is for the time being approved for the purpose of this clause by the Central Government by general or special order; and
- (iv) The institution or association shall invest or deposit its funds as specified in Sec. 11(5).

23A. Income of Professional Association / Institution

Any income (other than income chargeable under the head 'Income from house property' or any income received for rendering any specific services or income by way of interest or dividends derived from its investments) of an association or institution established in India having as its objects the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or such other profession as the Central Government may specify in this behalf, from time to time by notification in the Official Gazette. In order to claim exemption under this clause following conditions must be satisfied.

- (i) The association or institution applies its income, or accumulates it for application, solely to the objects for which it is established.
- (ii) The association or institution is for the time being approved for the purpose of this clause by the Central Government by general or special order.

23AA. Income of any Regimental Fund of the Armed Forces

Any income received by any person on behalf of any Regimental Fund or Non-Public Fund established by the armed forces of the Union for the welfare of the past and present members of such forces or their dependents is also tax free.

23B. Income from Khadi and Village Industries

Income of an institution constituted as a public charitable trust or registered under the Societies Registration Act and existing solely for the development of khadi and village industries and for purposes of profit. Income attributable to the business of production, sale or marketing of Khadi or products of village industries only will be exempt. The industries must also satisfy the following conditions in order to claim exemption under this section:

- (a) The institution must apply its income or accumulate it for application solely for the development of Khadi or Village Industries.
- (b) The institution must be approved for the purposes of this section by the Khadi and Village Industries Commission. Such approval shall not be granted for more than three years at a time.

23BB. Income of Khadi Board, Etc.

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

For the purposes of this clause, "Khadi" and "Village Industries" have the meaning respectively assigned to them in the Khadi and Village Industries Commission Act, 1956.

23BBA. Exemption in the Case of Statutory Bodies

Income of any body or authority established, constituted or appointed by the Central, State or Provincial Act will be exempt subject to the following:

- (a) It may be a body corporate or corporation sole.
- (b) The authority etc., is meant for the administration of the public religious or charitable trusts or endowments.
- (c) Muths, temples, gurudwaras, wakfs, churches, synagogues, agiaries are included in (b) above.
- (d) Societies for religious or charitable purposes registered as such under the Societies Registration Act, 1890 or under any other law are also covered here.
- (e) It is important to know that nothing contained here shall be constructed to exempt from the tax the income of any trust, endowment or society referred to therein.

23C. Income Received for Specified Charitable Fund, Etc

Any income received by any person on behalf of the following will be exempt from tax:

- (i) The Prime Minister's National Relief Fund;
- (ii) The Prime Minister's Fund (Promotion of Folk Art);
- (iii) The Prime Minister's Aid to Student Fund;
- (iv) Any other fund or institution established for charitable purposes and notified by the Central Government in this behalf;
- (v) Any trust or institution wholly for public, religious, charitable purpose may be notified by the Central Government.

23D. Income of Mutual Fund

Any Income of such Mutual Fund set up by a public sector bank or public financial institution shall be exempt subject to such conditions as notified by the Central Government.

The above exemption has been extended to other mutual funds authorized by the Securities and Exchange Board of India, w.e.f. the AY 1993-94.

23E. Income of Exchange Risk Administration Fund:

Any income of a notified Exchange Risk Administration Fund set up by public financial institution, either jointly or separately. However, any amount standing to the credit of the fund not charged to income tax during any previous year is shared (wholly or partly) with a public financial institution, the whole of the amount so shared shall be deemed to be the income of the previous year in which the amount is shared and shall be chargeable to income-tax.

24. Income of a Registered Trade Union

Any income chargeable under the 'Income from House Property' and 'Income from other sources' of a registered union within the meaning of Indian Trade Union Act, 1926, formed primarily for the purpose of regulation of the relations between workmen and employers or between workmen and workmen is exempt from tax.

25. Income accruing to Provident Funds

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

26. Income of a member of Scheduled Tribe

25. Income of Minor

In the case of a member of a Scheduled Tribe as defined in clause (25) of article 366 of the Constitution, residing in any area specified in Part I or Part II of the Table appended to paragraph 20 of the Sixth Schedule of the Constitution or in the Union Territories of Manipur and Tripura and income which accrues or arises to him:

(i) From any source in the area or territories aforesaid; or

(ii) By way of dividend or interest on securities.

26AA. Winnings from Sikkim Lottery

According to Finance Act, 1989 this exemption, subject to certain conditions, came into effect from the Assessment year 1990-91.

26B. Income of a Corporation

Any income of a corporation established by a Central, State or Provincial Act. The exemption will also be allowed to any other body, institution or association wholly financed by the Government. These must have been formed for promoting the interest of the members of either the Scheduled Caste or Scheduled Tribe or both.

28. Tax Credit Certificates

Any Amount adjusted or paid in respect of Tax Credit Certificate under provisions of Chapter XXII B (dealing with tax credit provisions, and any scheme made thereunder.

29. Letting of Godowns, etc.

In the case of an authority constituted under any law for the marketing of commodities, any income derived from the letting of godowns or warehouse for storage, processing or facilitating the marketing of commodities.

30. Subsidy from / through the Tea Board

In the case of an assessee who carries on the business of growing and manufacturing tea in India, the subsidy received from or through the Tea Board under any such scheme for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea as the Central Government may notify in the Official Gazette.

31. Subsidy from Rubber, Coffee or Spices Board

If a person carrying on the business of growing and manufacturing rubber, coffee, cardamom, etc., as notified by the Central Government receives any subsidy from or through the Board concerned under any scheme for replantation or replacement of plants or for rejuvenation or consolidation of areas used for cultivation of rubber, coffee, cardamom etc., the amount of such subsidy will be exempt in his hands.

32. Income of Minor

Where the income of an individual includes the income of his minor child under Sec. 64 (1A), such individual shall be entitled for exemption of the actual amount so includible or Rs. 1,500 which ever is less in respect of each minor child. This is applicable from the AY 1993-94.

Check Your Progress - 1

Decide whether the following are casual receipts or regular income.

- i) Amount received by a cricket player out of proceeds of a benefit match played for him.
- ii) Reward given to a servant by his master on finding out lost child without any prior announcement of reward.
- iii) Gift received on birthday.
- iv) Winning from lotteries.
- v) Interest on bank deposits.

Check Your Progress - 2

An assessee received Rs. 20,000 from horse races in the previous year. What is taxable part of it?

Check Your Progress - 3

List out any five exempted incomes.

6.4 EXEMPTIONS UNDER SEC. 10A AND SEC. 10B

Income from newly established industrial undertakings in free trade zone (Sec. 10A)

Income from newly established industrial undertakings in free trade zone will not be included in total income of the assessee in respect of any five consecutive assessment years, falling within a period of eight years beginning with the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture or produce articles or things, specified by the assessee at his option, if the following conditions are fulfilled:

- i) It begins to manufacture or produce articles or things during the previous year relevant to the assessment year 1981-82 or any subsequent assessment year in any free trade zone.
- ii) It is not formed by splitting up or the reconstruction of a business already in existence. However, this condition will not apply in respect of any industrial undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee under the circumstances and within the period specified (three years) u/s. 33B.
- iii) It is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Income from newly established hundred percent export-oriented undertaking (Sec 10B)

Income from newly established hundred percent export oriented undertaking will not be included in total income of the assessee in respect of any five consecutive assessment years, falling within a period of eight years beginning with the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture or produce articles or things, specified by the assessee at his option, if the following conditions are fulfilled:

- i) It manufactures or produces any article or thing.
- ii) It is not formed by splitting up or the reconstruction of a business already in existence. However, this condition will not apply in respect of any industrial undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee in the circumstances and within the period (3 years) specified in Section 33B.
- iii) It is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

6.5 REBATABLE INCOMES UNDER SEC. 86

Sec. 86 deals with the incomes which are included in total income but are exempt from income-tax at the average rate of tax applicable to the total income.

The following incomes are exempt from income-tax but are included in total income for the purposes of determining the rate of tax:

- 1). Share of profit of a partner in an un-registered firm not being an un-registered firm assessed as a registered firm u/s 183 (b) if income-tax on its total income is payable by

the firm (Sec. 86 (iii))

In this connection following points are worth noting:
a) If the income of an un-registered firm is not assessable (if the total income is below the exemption limit which is Rs. 22,000 at present) the partner shall not be entitled to exemption.

b) If the aggregate of incomes of the partners from the firm exceed the total income of the firm, the exemption shall be available to the extent of the income of the firm. This happens when the profits of the firm are apportioned among the partners according to the terms and conditions of the partnership deed. Some partners may end up with profit and others with loss. In such a situation the partners who receive profit are liable to pay income-tax on profits which are in excess of the exemption limit. In such a case the exemption is available to the partners who receive profit and not to the partners who receive loss.
(2) Share of profit of a member of an association of persons or body of individuals (other than a company or co-operative society or any other registered society) shall be dealt

a) Where the association of persons or body of individuals is taxed at the maximum rate, the share of profit of a member shall be dealt with as income of the member and not as income of the association. His total income at all.

b) Where the association or body of individuals is taxed at a rate lower than the maximum rate, the share of profit of a member shall be dealt with as income of the member and not as income of the association. The share of profit of a member shall be dealt with as income of the member and not as income of the association. The share of profit of a member shall be dealt with as income of the member and not as income of the association.

c) Where tax has been paid by the association or body at normal rates, income-tax shall not be payable in respect of such share, although it shall form part of total income of the member. It means on such share income-tax relief shall be allowed at the average rate of tax.

6.6 EXEMPTIONS UNDER SECTION 291

Exemption in relation to participation in business of prospecting mineral oils. (Sec. 293A)

If the Central Government is satisfied that it is necessary or expedient so to do in the public interest, it may, by notification, make an exemption, reduction in rate or other modification in respect of income-tax in favour of any class of the following persons:

6.2 REBATABLE INCOME UNDER SEC. 86

(1) Persons with whom the Central Government has entered into an agreement for association in participation of the Government or its authorised persons in any business consisting of the prospecting for mineral oils or petroleum or natural gas.

(2) Persons providing any services or facilities or supplying any ship, aircraft or refinery, plant (sale or hire) in connection with above business.

- 3) Employees of the persons mentioned in (1) and (2). In this connection the Central Government has provided that :

- a) Where the total income of any such person consists only of profits and gains derived from such business, the tax shall be payable @ 50% of such income;
- b) Where the total income of such person includes such profits and gains, the tax payable by him on his total income shall be :
 - i) the aggregate of the income-tax payable by him on the profits and gains of such business, plus
 - ii) income-tax on the balance of total income at the average rate of income-tax applicable to the total income, as if the rate of 50% was not applicable to any income.

6.7 SUMMING UP

6.9 MODEL EXAMINATION QUESTIONS

This Unit has been devoted to the various exclusions, exemptions and deductions allowable under the Income-Tax Act, 1961. These provisions would be repeated throughout the course at relevant places. However, you should know these concessions right in order that you would be in a position to appreciate the relevance of each and every concession in proper perspective.

There are certain exclusions. Section 10 enumerates certain incomes which remain outside the purview of income-tax and are not taxable under any of the heads of income.

Under Section 80A and 80B certain deductions are given to the newly established business undertakings. Under Section 86 certain incomes are eligible for rebates. Exemption in relation to participation in business or prospecting mineral oils is given under Section 293A.

Income is to be computed under five heads. Under each head of income certain deductions are allowable. These deductions represent expenditure incurred to earn income under those respective heads. In addition certain deductions are allowable by way of incentives for certain activities. Similarly, while allowing deductions, the Act prescribes certain conditions or restrictions with a view to prevent misuse of various incentives.

Once taxable income under various heads has been computed, it is aggregated and gross total income found out. Out of gross total income certain deductions are allowable and are again allowable for various reasons. It is the total income that comes after allowing all these deductions that is put to tax.

The chart appended at the end of this unit hereto should be consulted and studied by the students before pursuing the units further.

Discuss the following exemptions:

6.8 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Casual
- ii) Casual

(b) Perquisites outside India

iii) Casual

iv) Casual

v) Regular income

2. Exempted upto Rs. 5,000 and the remaining amount Rs. 15,000 is taxable.

3. i) Agricultural income

ii) Casual income

iii) Share from Hindu Undivided Family

iv) Interest paid to non-residents

v) Certain incomes received by non-citizens of India.

6.9 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following in about 30 lines each :

1. List out any 15 important incomes that are exempted from tax.
2. Do you think it is necessary to grant exemption in respect of many incomes? Discuss.
3. Explain the provisions applicable to a technician as regards exemption from tax.
4. What type of tax exemption is available to the members of Diplomatic Missions?
5. Describe the tax exemptions available to non-residents.

II. Short Questions

Answer the following in about 15 lines each :

1. Mention ten incomes which are exempted from tax.
2. Mention ten authorities who are not required to pay tax.
3. Mention the incomes that are not taxed in the hands of non-residents.
4. Could you give the justification of exempting income of Schedules Tribes?
5. Discuss the following exemptions:
 - (a) Subsidy received from Tea Board
 - (b) Perquisites outside India

(c) Casual and non-recurring receipts

(d) Agricultural income.

6. Describe the various exemptions in the hands of non-citizens.
7. Explain the exemptions under Sec. 10 A and 10 B.
8. Describe the rebatable incomes.
9. List out the exemptions u/s 293 A.

**Computation of
Gross Total Income, Total Income and Tax Payable at a Glance**

Particulars	Amount	Exemption	Rate
1. SALARIES			
Basic salary	...	...	...
Taxable allowances	...	...	...
Taxable value of perquisites	...	...	...
Gross Salary	...	...	...
Less deductions:			
Standard deduction	...	...	...
Professional tax	...	...	...
Entertainment allowance	...	...	...
Taxable income from salaries	...	...	...
2. INCOME FROM HOUSE PROPERTY			
Gross Rental Value	...	...	...
Less Municipal taxes etc.	...	...	...
Adjusted annual value	...	...	...
Less permissible deductions	...	...	...
Taxable income under the head	...	...	...
3. PROFITS & GAINS OF BUSINESS OR PROFESSION			
Net profits as per Profit & Loss Account	...	...	...
Add: Amounts shown as expenses but not permissible	...	...	...
Less: Expenses not shown but permissible	...	...	...
Less: Income shown on the credit side of the Profit & Loss Account but either not taxable or taxable under other heads	...	...	...
Add: Income not shown in the Profit & Loss Account but taxable under the head	...	...	...
Taxable profit under the head	...	...	...
4. CAPITAL GAINS			
Capital receipts	...	...	...
Less: Cost of acquisition	...	...	...
Cost of improvement	...	...	...
Transfer charges	...	...	...
Less: Deduction u/s 48 and exemptions u/ss 53, 54, 54B, 54D, 54E, 54F, and 54G	...	...	...
Taxable capital gains	...	...	...
5. INCOME FROM OTHER SOURCES			
Gross Income under the head	...	...	...
Less: permissible deductions	...	...	...
Taxable income under the head	...	...	...
Adjustments for carry forward and set off	...	...	...
Adjustments for clubbing provisions	...	...	...
Gross Total Income	...	...	...
Less: Deductions u/ss 80CCA to 80U	...	...	...
Total Income	...	...	...
6. COMPUTATION OF TAX LIABILITY			
Tax on Total Income	...	...	...
Less: Rebate u/s 86, 88 and 89	...	...	...
Tax deducted at source	...	...	...
Tax paid in advance	...	...	...
Tax to be paid	...	...	...

BLOCK - III

HEADS OF INCOME

This block discusses the various heads of Income. There are five heads of income under which all types of incomes can be grouped. They are :

- Unit - 7 : Salaries - I**
- Unit - 8 : Salaries - II**
- Unit - 9 : Income from House Property**
- Unit - 10 : Profits and Gains of Business or Profession - I**
- Unit - 11 : Profits and Gains of Business or Profession - II**
- Unit - 12 : Depreciation and Investment Allowance**
- Unit - 13 : Capital Gains**
- Unit - 14 : Income from Other Sources.**

UNIT - 7 : SALARIES - I [SEC. 15 TO 17]

Contents

- 7.0 Aims and objectives
- 7.1 Introduction
- 7.2 Chargeability
- 7.3 Main Characteristics of Salary
- 7.4 Definition of Salary
- 7.5 Definition of perquisites
- 7.6 Tax Free Benefits
- 7.7 Profits in lieu of Salary
- 7.8 Tax Free Receipts in the Hands of Employees
- 7.9 Various Allowances and their Taxability
- 7.10 Summing Up
- 7.11 Check Your Progress: Model Answers
- 7.12 Model Examination Questions

7.0 AIMS AND OBJECTIVES

The objective of this unit is to explain you various provisions determining the computation of taxable income under the head 'Salaries'.

On completion of this unit, you will be able to:

- list out the incomes chargeable under the head 'Salaries';
- explain main characteristics of salary;
- define salary and perquisites;
- explain tax free receipts in the hands of employees;
- list out the tax free benefits; and
- describe various allowances and their taxability.

7.1 INTRODUCTION

We now introduce you to the computation of income according to the income-tax provisions.

All incomes shall for the purposes of charge of income tax and computation of total income be classified under the following five heads of income under Section 14 of the Act.

- A. Salaries,
- B. Income from House Property,
- C. Profits and Gains of Business or Profession,
- D. Capital Gains,
- E. Income from Other Sources.

You have already studied that various types of deductions have been permitted under different heads in computing taxable income under the respective heads. Since the deductions vary from one head to the other, it is necessary that income pertaining to a specific head is to be computed under that head only. It is obligatory on the part of the department to follow this rule strictly. There may arise a situation where a particular amount could be taxed under two heads, at that time the choice will have to be exercised by the assessee and he will have it taxed under the head which is advantageous to him. You will notice from the heads given to above that the first four heads are specific in nature whereas the last head is all inclusive for the residuary incomes. All these incomes that could not be included in the first four heads are included in the last head.

Two units are devoted to the first head and in these two units, we will deal with the various provisions determining the computation of taxable income under this head. Unit 8 will deal with the practical problems on a bigger scale. Once you have mastered the provisions here, it should be possible for you to help the salaried assessee to calculate their tax liability and file the return of income.

7.2 CHARGEABILITY (SECTION 15)

According to section 15, the following incomes shall be chargeable under the head 'salaries'.

- (a) *Salary Due:* Salary due from the present or former employer in the previous year whether paid or not.
- (b) *Salary received:* Salary paid or allowed in the previous year on behalf of the present or former employer, due or paid in advance.
- (c) *Arrears of Salary:* Arrears of salary paid or allowed in the previous year by or on behalf of the present or former employer, if not charged to income-tax in any earlier previous year.

Sometimes the fixation of salary or revision of salary is done with retrospective effect and as a result the employee is in receipt of arrears in the current year for the services rendered in the past. In such cases arrears are taxed in the year of receipt thereof.

Note: For the removal of doubts, it has been stated that where any salary paid in advance is included in the total income of any person for any previous year, it shall not be included

in the total income of the person when the salary becomes due.

Any salary, bonus, commission or remuneration by whatever name called due to or received by a partner of a firm from the firm shall not be regarded as salary for the purposes of this section w.e.f. AY 1993-94.

7.3 MAIN CHARACTERISTICS OF SALARY

- (a) *Accrual and Receipt Basis:* 'Salary' is taxed both on the basis of accrual as well as receipt. In other words, whether the amount is received or not it will be charged once it has become due. On the other hand it will also be charged if the amount has been received without having accrued. For example, salary received in advance is taxable.
- (b) *Employer and Employee-Relationship:* The amount is taxable here only when an employee received it in the capacity of an employee, that is, there must exist the relationship of an employer and the employee. Income received from any activity which is not employment is not taxable here. Employer includes Government, Local Authority, company, firm, Foreign Government or any employer in private or public sector.

An agent, a company director, a singer, an artist, a doctor, a chartered account, an advocate, etc., who are practising their profession independently, are not employees and therefore whatever amounts they earn should be taxed as professional income under the head profits and gains from business or profession.

- (c) *Tax Free Salary:* You may come across certain references when it is stated that employee X is in receipt of tax-free salary from his employer. In this regard you will have to follow the points given here under:
 - i) It is not possible for any one to say that this employee will receive tax-free salary, because it is only the Central Government which can declare that such and such employee will not be taxed in respect of salary.
 - ii) 'Tax free' salary will therefore means that the tax liability of the employee will be met by the employer in addition to paying salary as agreed to. In this case since the employer is meeting the obligation of the employees as regards tax, the tax so paid will be deemed to be the income of the employee when his assessment is taken up.
 - iii) Companies Act, 1956, prohibits the payment of tax free salary to any of its employees. However, the company may seek permission from the Central Government to allow it to pay salary to the employee and meet his obligation too.
- (d) *Previous Year:* Salary is generally assessable on the basis of financial year, that is, the previous year for any assessment year of any employee should generally be the financial year immediately preceding the assessment year. It is generally assumed that the salary for any month becomes due on the last day of month. For the assessment year 1992-93 the employee will be required to pay tax on the salary he has earned for the financial year

commencing on 1st April, 1991 and ending on 31st March 1992.

In case of government and semi-government departments, salary, is supposed to become due on the first of the next month and therefore in respect of such employees tax will be charged in respect of the year commencing on 1st March 1991 and ending on 28th February, 1992 assuming that the salary for the month of February 1991 becomes due on 1st March 1991, and the salary for March, 1992 on 1st April 1992.

- (e) *Voluntary Foregoings*: Sometimes the employee decides to forego his salary and accepts only a token amount of Re. 1 per month. He has to accept rupee one because in the absence of even this rupee one, there will not be any consideration and therefore there will not exist any contract between the employer and the employee. Where the employee foregoes his salary, his tax liability will get reduced and he will have to pay income tax on his entire salary notwithstanding that he has foregone a part or the full amount of salary. However, if the employee has complied with the various provisions given in the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, tax liability will certainly get reduced.
- (f) *Scope*: Under the head 'Salaries' are taxed on the following:
 - (a) Salary
 - (b) Perquisites
 - (c) Profits in lieu of Salary

7.4 DEFINITION OF SALARY [SECTION 17 (1)]

The term 'salary' includes the following:

- (a) Wages;
- (b) Any annuity or pension;
- (c) Any gratuity;
- (d) Any fees, commission, perquisites or profits in lieu of or in addition to any salary or wages;
- (e) Any advance of salary;
- (f) Any payment received by an employee in respect of any period of leave not availed of by him (leave encashment);
- (g) The annual accretion to the balance to the credit of an employee participating in a Recognised Provident Fund to the extent it is chargeable to tax; and
- (h) The aggregate of all sums that are comprised in the transferred balance of an employee participating in Recognised Provident Fund, to the extent of which it is chargeable to tax.

The above amounts are chargeable whether they are a part of the contract of employment, or are paid by the employer voluntarily. Salary for the notice period paid by the employer is also chargeable. Annuity is an annual payment, where the employer has made arrangements for the payment of any amount for his past service, the receipt is taxable. Pension is included under this head. Gratuity is the lumpsum payment made by the employer at the time of retirement or leaving of the service. This is made in appreciation of his past services. The amount is tax-free within the limits provided in Section 10 (10). Any amount falling outside that limit will be taxed as usual.

Advance salary is also chargeable. But if some amount has been received by the employee as loan which is to be repaid every month out of salary, it is not taxable. Loan arrangement is a private financial agreement and does not attract tax. The amount of provident fund contribution by the employer and interest thereon is termed as annual accretion and taxable if outside the tax-free limit. The balance standing to the credit of unrecognised provident fund at the time when it is recognised by the Commissioner of Income-Tax is transferred to the Recognised Provident Fund and is known as 'transferred balance'. This is also taxed beyond certain limit.

7.5 DEFINITION OF PERQUISITES [SECTION 17 (2)]

Perquisite is defined in Webster's New International Dictionary as 'a gain or profit incidentally made from employment in addition to regular salary or wages, especially one of a kind expected or promised'. In Oxford dictionary it is defined as 'casual emolument, fee or profit attached to an office or position in addition to salary or 'wages'. Perquisites are received in a number of ways. They may be received in kind which may or may not be convertible into cash.

You might have seen many top class officers enjoying some benefits during office hours or during the course of discharge of official duties. They will not be perquisites in the eyes of income-tax. For example, during office hours you have a ride in office car, use office telephone, take lunch while giving company to the employer's client, all such benefits are not at all perquisites that are taxable.

You will remember one thing. If a benefit is a perquisite according to the income-tax law, it is certainly taxable in view of the definition of salary given under Section 17 (1).

The term perquisite as defined under Section 17 (2) will include the following:

- (a) *Rent-free Accommodation [17 (2) (i)]*: The value of rent free accommodation provided to the assessee by his employer.
- (b) *Concession in Rent [17 (2) (ii)]*: The value of any concession in the matter of rent for any accommodation provided to the assessee by his employer.
- (c) *Any Other Benefit or Amenity [17 (2) (iii)]*: The value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases:
 - (i) By a company to an employee who is a director thereof;
 - (ii) By a company to an employee being a person who has a substantial interest in the company (i.e. who holds at least 20% of the voting power);

- (iii) By any employer to an employee to whom the provisions of (a) and (b) above do not apply and whose income under the head 'salaries' exclusive of the value of all benefits and amenities not provided for by way of monetary payment exceeds Rs. 24,000. It is important to note that it is the net monetary emoluments after allowing standard deduction that should be considered for this sub-clause.
- (d) *Employee's Obligation [17 (2) (iv)]*: Any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee.
- (e) *Life insurance etc. [17 (2) (v)]*: Any sum payable by the employer, whether directly or through a fund other than a recognised provident fund or approved superannuation fund to effect an assurance on the life of the assessee or to effect a contract for annuity.

The benefits described under (a), (b) and (e) are specific and therefore identification of perquisites would be easier. They are taxable in all cases. As regards the benefits to be covered by (c) and (d), there are problems. If the benefit is covered by (c), it will be taxable only in the hands of specified persons described under (i), (ii) and (iii) above. On the other hand if it is covered by (d), it is taxable in the hands of all.

To illustrate, if the employee owns a car and petrol charges are payable by the employer towards the private usage, it is taxable in the hands of all employees. When the car is owned by the employee, it is his obligation to spend for petrol and run it. If his liability to petrol charges is discharged by the employer, it is a taxable perquisite in the hands of all types of employees.

On the other hand if the car is given by the employer for private use it will be taxed as perquisite under 17 (2) (iii) and therefore only the specified types of employees would be required to pay tax.

7.6 TAX-FREE BENEFITS

We have explained just now in this unit that various types of benefits derived by the assessee are taxable. However, there are certain advantages and benefits which have been made tax-free by the administrative orders of the Board. They are in brief described below:

1. Medical Facilities:

As per Finance Act, 1991, the following shall not be regarded as perquisites w.e.f. the A.Y. 1991-92 (Sec.7)

- i) the value of any medical treatment provided to an employee or any member of his family in any hospital maintained by the employer;
- ii) any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family in any hospital maintained by Government or any local authority or any other hospital approved by the Government for the purposes of medical treatment of his employees;
- iii) any portion of the premium paid by an employer in relation to an employee, to effect or to keep in force an insurance on the health of such employee under any scheme approved

by the Central Government for the purposes of clause (b) of sub-section (1) of section 36;

- iv) any sum paid by the employer in respect of any premium paid by the employee to effect or to keep in force an insurance on his health or the health of any member of his family under any scheme approved by the Central Government for the purposes of section 80D;
- v) any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment of any member of his family [other than the treatment referred to in clauses (i) and (ii)], so, however, that such sum does not exceed ten thousand rupees in the previous year;
- vi) any expenditure incurred by the employer on -
 - 1) medical treatment of the employee, or any member of the family of such employee, outside India;
 - 2) travel or stay abroad of the employee or any member of the family of such employee for medical treatment;
 - 3) travel and stay abroad of one attendant who accompanies the patient in connection with such treatment.

Subject to the condition that the expenditure on travel referred to in sub-clauses (2) and (3) of this clause shall be excluded from perquisite only in the case of an employee whose gross total income, as computed before including therein the said expenditure, does not exceed one lakh rupees and subject to such further conditions and limits in relation to such expenditure as the Board may, having regard to the guidelines, if any, issued by the Reserve Bank of India in this behalf, prescribe;

- vii) any sum paid by the employer in respect of any expenditure actually incurred by the employee for any of the purposes specified in clause (vi) subject to the conditions specified in or under that clause.

Notes:

- 1) w.e.f. the A.Y. 1993-94 the above sub-clause (ii) has been bifurcated as follows:

"ii) any sum paid by the employer -

- a) in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family in any hospital maintained by the Government or any local authority or any other hospital approved by the Government for the purposes of medical treatment of its employees;
- b) directly to a hospital, approved by the Chief Commissioner having regard to the prescribed guidelines for the purposes of medical treatment of the prescribed diseases or ailments, on account of such treatment of the employee or any member of his family".

- 2) in clause (vii), for the words "one lakh rupees", words "two lakh rupees" shall be substituted.
- 2) **Refreshment:** Provision of refreshments during office hours in office premises.
 - 3) **Recreational Facilities:** Provision of recreational facilities for group of employees (the facilities should not be restricted to a selected few).
 - 4) **Perquisites Abroad:** perquisites to Government employees while serving in foreign countries.
 - 5) **Free Ration to Armed Forces:** Free ration and provisions to members of the armed forces given under service conditions.
 - 6) **Refresher Courses:** Courses and training programmes arranged for the employees, refresher courses for the executives, management development and executive development programmes.
 - 7) **Transport Facilities:** Transport facilities for going to and coming from place of work.
 - 8) **Family Planning:** Expenses incurred on family planning programmes and benefits derived by employees thereunder.
 - 9) **Telephones:** Free telephones at employee's residence.
 - 10) **Free Travel:** Free travel passes and privilege ticket orders enjoyed by railway or airlines employees.
 - 11) **Availability of Goods at Concessional Rate:** Availability of goods at concessional rate from employer.

7.7 PROFITS IN LIEU OF SALARY [17 (3)]

"Profits in lieu of salary" include:

- (a) The amount of any compensation due to or received by an assessee from the employer or in connection with the termination of his employment. It may also be received for modification of the terms and conditions relating thereto.
- (b) Any payment due to or received by an assessee from an employer or a former employer or from a provident fund to the extent it is taxable.

Any other payment received from the present or the past employer is also taxable as profit in lieu of salary. Where the pension is payable as deferred remuneration any amount received for commutation of pension or substitution thereof shall be treated as profits in lieu of salary and taxed accordingly.

7.8 TAX - FREE RECEIPTS IN THE HANDS OF EMPLOYEES

Certain amounts received by the employees are tax free under various provisions of the Act.

Following are the provisions in this regard:

(i) Travel Concession [10(5)]:

The value of any travel concession or assistance received by an individual (who is a citizen of India) from his employer for himself, his spouse and children in connection with his proceedings on leave to his home district in India. Such concessions received from his former employer after retirement from service or after the termination of service are also exempt. The value of travel concession will be exempt subject to the following conditions:

- (a) Leave travel concession is tax free where the employee is entitled to it only once in a block of four years irrespective of distance. Where he is entitled to more than once in the block of four years, the first concession will be exempt in full and the subsequent ones would be exempt to the extent of the fare for the distance between the work place and his home town.
- (b) Where he has not availed himself of such concession during any block of four calendar years, the value of the travel concession first availed of by the individual during the first calendar year of the immediately succeeding block of four years will get exemption (Rules 2B)

(ii) Death-cum-Retirement Gratuity [10(10)] :

Any death-cum-retirement gratuity received under the following schemes shall be exempt:

- a) Government Employees: Any such amount received by the employees working in Civil or Defence services of Government of India, or on any part of State Government or Local Authority covered under Revised Pension Rules of the Central Government shall be fully exempted.
- b) Gratuity received under Payment of Gratuity Act, 1972 : In case of employees drawing salary not exceeding Rs. 2,500 p.m. and covered by the Payment of Gratuity Act, 1972, an amount being least of the following three items shall be exempted and excess if any, will be taxable. Three items are :
 - i) 15 days salary for each year of completed service or part thereof in excess of six months.
 - ii) Notified limit Rs. 50,000.
 - iii) Gratuity actually received by the employee.

'Salary' means salary last drawn by the employee and it also includes dearness allowance, but excludes all other allowances. Monthly salary shall be calculated by taking 26 days as the maximum number of working days in a month. For example, if the employee was drawing Rs. 1,300 at the time of his retirement, then 15 days salary shall be :

$$1300 \times \frac{15}{26} = \text{Rs. } 720.$$

- c) Other Employees: In case of other employees, out of the gratuity received by them, least of the following three will be exempted from tax:
- Actual gratuity received;
 - 1/2 month's average salary for each completed year of service; or
 - Notified limit Rs. 1,00,000.

For this purpose, 'salary' means average salary for ten months immediately preceding the month in which retirement or death occurs. 'Completed Year' means one full year, fraction of year is to be ignored. The word 'salary' here has the same meaning as is assigned to it for provident fund purposes, i.e., the basic pay plus DA or any portion of DA which enters into pay for service benefits. Further, if under terms of employment, commission is payable at a fixed percentage of turnover realised by the employee, it will be a part of salary.

If an employee receives gratuity from more than one employer either in the same year or in different years, the total exemption will not exceed Rs. 1,00,000.

Illustration-1 :

Mr. Sudhir retires from his job on 30th November, 1991 after putting 30 years and 7 months service. He received Rs. 40,000 as gratuity under the Payment of Gratuity Act, 1972. His salary including Dearness Allowance at the time of retirement was Rs. 1,950. Compute the exempted gratuity.

Solution :

Least of the 3 items shall be exempted:

- $31 \times 1,125 = \text{Rs. } 34,875$ (least)
- Actual amount Rs. 40,000.
- Notified limit Rs. 50,000.

Taxable Gratuity shall be = Rs. 40,000 – Rs. 34,875 = Rs. 5,125.

Monthly salary has been calculated as

$$\text{Rs. } 1,950 \times \frac{15}{26} = \text{Rs. } 1,125.$$

Illustration-2

X, an employee retired on 31st March, 1992 after completing 32 years of service. He received Rs. 60,000 by way of gratuity. The average salary drawn by him in the ten months preceding the month in which he retired was Rs. 3,200 p.m. What amount of gratuity will be exempt if he was i) a government employee; or ii) an employee in the private sector?

Solution :

- i) If he was a government employee, the entire amount of gratuity paid to him will be exempt from tax.
- ii) For an employee in the private sector, the least of the following three figures will be exempted from tax:
 - a) $1/2$ month's average salary for each completed year of service, i.e., 16 months' salary for 32 years of service (Rs. $1,600 \times 32$) Rs. 51,200.
 - b) Actual gratuity received Rs. 60,000.
 - c) Notified limit Rs. 1,00,000.

The least figure of the above three, i.e., Rs. 51,200 will be exempt from tax. The taxable gratuity will, therefore, be (Rs. 60,000 - 51,200) = Rs. 8,800.

iii) **Commutation of Pension [10(10A)] :**

Pension is the periodic payment made by the former employer to the employee who has since retired. This is according to the terms of the contract of employment. Sometimes the employee wants to have a lumpsum payment in lieu of pension which he would receive monthly. The payment which he receives on foregoing of the pension is known as commuted value of pension.

The commuted value of pension is determined having regard to the age of the recipient, state of his health, the rate of interest and officially recognised tables of mortality. He may forego a part of the pension or full pension as per his wishes and conditions with the employer. This sub-section exempts commutation of pension within the following limits:

- (i) Payment by way of commutation of pension made by the Government-State as well as Central or a Corporation established by State or Central Act will be totally tax-free.
- (ii) Where the commutation is paid by any other employer the exemption will be within the following limits:
 - (a) Where the employee receives gratuity in addition to pension the commuted value of only $1/3$ rd of the pension will be tax free.
 - (b) In any other case, the commuted value of only one-half of the pension will not be taxed.

(iv) **Encashment of Leave after Retirement [10(10AA)]**

You might be aware that generally employees in the private and public sectors are allowed to enjoy earned leave. For each year of service, the leave account of the employee is credited by a certain number of days, say, one month. This leave gets accumulated in his account. Of late, the employees have been given the benefit of encashment of such leave. In other words the employee

is eligible to claim one month's leave which he would otherwise be entitled to. He will in such a case forego leave and instead claim salary for the period foregone. Such encashment is taxable during the course of the employment. However, if the employee has got some leave credited to his leave account at the time of retirement, he is entitled to claim encashment of such leave. Encashment of leave at the time of retirement is exempted from tax subject to the provisions given below.

1. Central/State Government Employees : Any payment received as the cash equivalent of the leave salary in respect of the earned leave to his credit at the time of his retirement shall be fully exempted.
2. Other Employee's : Exemption in this respect is also available to the other employees, but with certain limitations, which are given below:
 - (a) The earned leave to the credit of the employee should not exceed 8 months at the time of retirement, superannuation or otherwise.
 - (b) The encashment shall be calculated on the basis of the average salary drawn by the employee during the period of ten months immediately preceding his retirement subject to such limit as the Central Government may, by notification in the Official Gazette, specify, in this behalf having regard to the limit applicable in this behalf to the employees of that Government. The present exemption limit is Rs. 79,920.
 - (c) Where any such payments are received by an employee from more than one employer in the same previous year, the aggregate amount exempt from income-tax under this sub-clause shall not exceed limit so specified.
 - (d) Where any such payment or payments was or were received in any one or more earlier previous years also and the whole or any part of the amount of such payment was or were not included in the total income of the assessee of such previous year or years, the amount exempt from income-tax under this sub-clause shall not exceed the limit so specified as reduced by the amount not included in the total income of any such previous year or years.
 - (e) The entitlement of earned leave of an employee (including Government employees) shall not exceed 30 days for every year of actual service rendered by him as an employee of the employer from whose service he has retired.
 - (f) Salary for this purpose includes dearness allowance if the terms of employment so provide but excludes all other allowances and perquisites.

Exempted Leave encashment amount in the case of other Employees:

In this case, minimum of the following four will be exempted from tax :

- (i) Leave encashment actually received; or
- (ii) Cash equivalent of earned leave not exceeding 30 days per each year of service at his credit on retirement; or

- (iii) Eight months average salary; or
- (iv) Amount specified by the Central Govt.
(1st January, 1988 onwards Rs. 79,920/-).
- (v) *Compensation [10(10-B)] :*

Compensation received by a workman under the Industrial Disputes Act, 1947, or under any other Act, Rules, Orders, Notification Award or Contract of Service etc., at the time of retrenchment shall be tax free to the following extent:

- (i) An amount calculated in accordance with the provisions of Section 25-F (b) of the Industrial Disputes Act; or
- (ii) Rs. 50,000 ; whichever is less.

Explanation : Retrenchment compensation includes compensation received at the time of closing down of the undertaking.

The Finance Act, 1985 has provided that the above limit will not apply from the A.Y. 1986-87 in cases where compensation is paid under any scheme approved by the Government.

- (vi) *Compensation received by a Public Sector employee at the time of voluntary retirement (10(10C)) :*

Any payment received by an employee of a Public Sector Company at the time of his voluntary retirement in accordance with any scheme approved by the Central Government is exempt from tax from the A.Y. 1987-88. This exemption is available to any employee, whether a worker or an executive.

The above exemption is extended to the private sector employees also w.e.f. A.Y. 1993-94.

- (vii) *Payment From Statutory Provident Fund [10(11)]*

Provident Fund scheme is essentially a labour welfare measure. It is constituted of the contributions from the employee and employer both. The amount so collected is invested to earn interest thereon which again goes to the employee. The amount so accumulated in his account is paid back to him when he retires from service or leaves it earlier. The payment so made over to him is tax free subject to certain provisions.

One type of provident fund is statutory provident fund which is administered according to the provisions laid down by the Government. Any payment back from the Statutory Provident Fund is totally tax free in the hands of employees.

For detailed discussion on the subject, you will see the next unit.

- (viii) *Payment from Recognised Provident Fund [10(12)] :*

Payment received from any Recognised provident Fund shall also be tax-free provided the

following conditions are fulfilled :

- (a) The employee has rendered a continuous service for a period of at least five years.
- (b) Though the employee has failed to put in five years continuous service, it has come to an end for reasons beyond his control.

(ix) Payment from Approved Superannuation Fund [10(13)]

Any of the following payments made from an approved superannuation fund are not included in the total income of the employee.

- (a) On the death of the beneficiary.
- (b) To an employee in lieu of or in commutation of any annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement.
- (c) By way of refund of contributions on the death of a beneficiary.
- (d) By way of refund of contributions of an employee on his leaving the service otherwise than by retirement at or after a specified age or on his becoming incapacitated prior to such retirement, the extent, to which such payment does not exceed the contributions made prior to 1-4-1962 and any interest thereon.

(x) House Rent Allowance [10(13A)]

House rent allowance is granted to employees to meet the cost of high rent prevailing in big cities. It is therefore an accepted fact that the receipt of this allowance does not increase the taxable capacity of the employees. It is therefore tax free but within certain limits. The limits are being discussed in the following pages.

(xi) Special Allowance for meeting Business Expenditure [(10)(14)]

Any special allowance or benefit not being in the nature of an entertainment allowance or other perquisite within the meaning of Section 17 (2) specifically granted to meet expenses wholly necessarily and exclusively incurred in the performance of the duties of an office or employment of profit, to the extent to which such expenses are actually incurred for that purpose.

Check Your Progress - 1

List out the important tax-free receipts in the hands of employees.

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7.9. VARIOUS ALLOWANCES AND THEIR TAXABILITY

We are all aware that the employees are in a position to receive remuneration under various names. The employer allows a number of allowances to be withdrawn by the employees. Some of these allowances are paid just to meet the expenditure the employee incurs in relation to his employment, whereas certain other allowances are granted with a view to giving extra amounts to employees. We propose to discuss various allowances and their taxability.

(i) Dearness Allowance

Dearness allowance is given to meet the rising cost of living. There is a general assumption that the rise in cost is temporarily for the time being and therefore it could be met by an allowance. If the rise comes down, the allowance is also reduced. Dearness allowances is treated like any other taxable income in the Act.

(ii) Travelling Allowance

Travelling allowance is paid to meet the cost of travel and therefore you will agree that it is not at all income. However, if the employee is able to save something out of the allowance he receives, it is taxable because the amount saved will be his income without any doubt.

(iii) Foreign Allowance

This allowance is paid by the Government to its employees who are citizens of India and who have been posted abroad. It is not included in total income and is totally exempt.

(iv) House Rent Allowance

House rent allowance is paid to employees for meeting high cost of rent prevailing in big cities. This allowance is exempted within the prescribed limits. The excludible limit will be least of the following:

- (a) Actual allowance received ;
- (b) Excess of rent paid over 10% of salary ;
- (c) Where the accommodation is situated at Bombay, Calcutta, Delhi or Madras, 50% of the salary due to the assessee;
where the accommodation is situated at any other place, 40% of the salary due to the assessee.

'Salary' for this purpose includes dearness allowance if the terms of employment provide for its inclusion in salary for the calculation of old age benefits, etc. But excludes all other allowances and perquisites.

The excludible limit is to be worked out only for the duration the assess has occupied the accommodation during the previous year.

It has been clarified by the Board that the house rent allowance paid to a person who is living

in his own house or in a house for which he does not pay any rent is not exempt from tax in any circumstances.

Illustration

Compute total salary of the following four assesseees for the assessment year 1992-93

Particulars of Income	Names of the Assesseees			
	M	N	O	P
Salary	25,000	30,000	40,000	25,000
D.A.	8,000	14,000	4,000	5,000
Bonus	7,000	—	15,000	8,000
House Rent Allowance	4,250	8,000	21,500	13,750
Actual rent paid	6,500	7,000	20,500	16,000
Place of service	Kanpur	Tirupati	Poona	Delhi

Note : N is the only assessee whose salary includes dearness allowance for the purposes of provident fund contribution.

Solution

Computation of Salary

	Rs.	Rs.
M : Salary		25,000
Dearness Allowance		8,000
Bonus		7,000
House Rent Allowance	4,250	
Less : Deductible amount *	4,000	250
Total Salary		40,250

*Deductible amount is calculated below:

(i) 40% of salary (Kanpur)	10,000	
(ii) Excess of actual rent over 10% of salary (6,500-2,500)	4,000	
(iii) Actual house rent allowance received Whichever is less i.e. Rs. 4,000.	4,250	
N : Salary		30,000
Dearness Allowance		14,000
House Rent Allowance	8,000	
Less : Deductible amount *	2,600	5,400
Total Salary		<u>49,400</u>

*For deductible amount, following calculations are useful :

(i) 40% of salary (30,000 + 14,000) (Tirupati)	17,600	
(ii) Excess of actual rent over 10% of salary (7,000-4,400)	2,600	
(iii) Actual house rent allowance Whichever is less i.e. Rs. 2,600	8,000	
O : Salary		40,000
Dearness allowance		4,000
Bonus		15,000
House rent allowance	21,500	
Less : Deductible amount *	16,000	5,500
Total Salary		<u>64,500</u>

Deductible amount is calculated below :

(i) 40% of salary (Poona)	16,000
(ii) Excess of actual rent over 10% of salary (20,500-4,000)	16,500
(iii) Actual house rent allowance Whichever is less i.e. Rs. 16,000	21,500

P : Salary		
		25,000
Dearness allowance		
		5,000
Bonus		
		8,000
House rent allowance		
	13,750	
Less : Deductible amount *		
	12,500	1,250
Total Salary		39,250

*Deductible amount is worked out below :

(i) 50% of salary (Delhi)	12,500
(ii) Excess of actual rent over 10% of salary (16,000-2,500)	13,500
(iii) Actual house rent allowance Whichever is less i.e. Rs. 12,500	13,750

(v) Entertainment Allowance

Entertainment allowance is granted to employees to meet the cost of entertainment of customers or clients of the employers. It is supposed to have been spent by the employees for the purpose. It is therefore, necessary that the full allowance is not taxed. In the past it was not taxed. But the employers started making use of this allowance for paying salary and helping the employee to reduce his tax liability. These days it is exempt from gross salary under section 16 (ii). Amount paid in excess over the limit is taxable. The exempted limit is as under :

In case of employees in Private Sector

1. Rs. 7,500 per annum; or
2. 1/5th salary (exclusive of any special allowance, benefit or other perquisite) or;
3. Allowance which was received by the assessee from the present employer before 1-4-1955; or
4. Allowance which is being drawn now; whichever is less.

In case of employees in Government Services

1. 1/5th Salary (exclusive of any allowance, benefit or other perquisite); or
2. Rs. 5,000 per annum; or
3. Allowance which is being drawn now, whichever is less.

It is to be understood that the entertainment allowance must first be added to salary and then

deduction in this behalf allowed in the manner given above. In case of employees in private employment, deduction shall not be allowed if the employee has changed the employer since 1-4-1955 and/or where the entertainment allowance was not available to him before 1-4-1955.

It will be interesting to know that the deduction on account of entertainment allowance is a matter of academic interest now as regards the private sector employees because there will be very few persons in the country who have been in the same employment since before 1-4-1955 getting entertainment allowance.

(vi) City Compensatory Allowance

City Compensatory Allowance is paid to employees in bigger cities because of higher cost of living at those place. It is taxable in full.

(vii) Conveyance Allowance

Conveyance allowance is paid to employees to meet the cost of conveyance. They are likely to incur while travelling for office purposes. It is therefore not taxed in the hope that the whole amount must have been spent.

(viii) Bonus is taxable in full

Check Your Progress - 2

Mr. Rao, a university teacher in Hyderabad is in receipt of salary @ Rs. 1,800 p.m., D.A. @ Rs. 200 p.m. and House Rent Allowance (HRA) Rs. 4,000 p.a. He paid Rs. 5,400 as actual rent for the house occupied by him. Calculate his taxable HRA.

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Check Your Progress - 3

Mr. Reddy is working as a manager at Rs. 2,200 p.m. in a bank in Vijayawada. He is receiving Rs. 400 p.m. as D.A. and Rs. 300 p.m. as HRA. He stays in his own house. Compute his taxable HRA.

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Check Your Progress - 4

List out some important Tax Free Benefits.

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7.10 SUMMING UP

The term 'Salary' includes various types of monetary emoluments received from the employer e.g; perquisites granted by the employer and profits in lieu of salary. Any gain or profit received in addition to regular salary is known as perquisite. It includes rent free accommodation, concession in rent, any other benefit or amenity, etc. There are certain benefits like medical benefits, refresher courses, transport facilities which are not taxed at all. Employees receive various allowances like Dearness Allowance, Travelling Allowance, House Rent Allowance, Entertainment Allowance. The Taxability of these allowances is also discussed in this unit.

7.11 CHECK YOUR PROGRESS : MODEL ANSWERS

- i) Travel Concession;
- ii) Death - cum - Retirement Gratuity;
- iii) Commutation of pension;
- iv) Encashment of Leave after retirement;
- v) Payment from Statutory and Recognised Provident Funds.

2. Computation of Taxable HRA of Mr. Rao
HRA Received

Rs. 4,000

Less : Exempted upto least of the following:

i) Actual HRA Rs. 4,000

ii) Rent paid over 10% of salary
(5,400 - 2,160) 3,240

iii) 40% of salary 8,640
Exempted

3,240

Taxable HRA

Rs. 760

3. Taxable HRA Rs. 3,600

(As he is living in his own house, HRA is fully taxable.)

4. i) Medical Facilities ;
ii) Telephones;
iii) Refreshment,
iv) Recreational Facilities,
v) Perquisites Abroad
vi) Transfer Facilities,
vii) Free Travel, etc.

7.12. MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following in about 30 lines each :

1. Explain the provisions regarding encashment of leave at the time of retirement.
2. Name various allowances and explain their taxability.
3. Give main characteristics of 'Salary'
4. What are the rules relating to the taxability of tax free Salary?

II. Short Questions

Answer the following in about 15 lines each :

1. Name various taxable perquisites.
2. Enumerate tax free benefits.
3. Explain the provisions with regard to travel concession.
4. How is commutation of pension taxed?
5. How is house rent allowance taxed?
6. How do you treat voluntary foregoings?
7. Define profits in lieu of salary.

UNIT - 8 : SALARIES - II

Contents

- 8.0 Aims and Objectives
- 8.1 Introduction
- 8.2 Valuation of Perquisites
- 8.3 Standard Deduction
- 8.4 Provident Funds
- 8.5 Income-tax Provisions on Provident Funds
- 8.6 Computation of Salary Income
- 8.7 Qualifying Amount and Rebate of Tax
- 8.8 Illustrations
- 8.9 Summing Up
- 8.10 Check Your Progress : Model Answers
- 8.11 Model Examination Questions

8.0 AIMS AND OBJECTIVES

The objectives of this unit are to explain the valuation of perquisites, deductions from salaries and then provident funds. Through this unit an effort would be made to impart training to you in computing taxable income from salaries.

At the end of the unit, you should be able to :

- explain valuation of perquisites;
- identify the perquisites taxable in specified cases;
- explain Standard Deduction;
- describe provisions relating to provident funds;
- compute salary income; and
- understand qualifying amount and rebate of tax

8.1 INTRODUCTION

In the seventh unit we have defined perquisites and have also described the benefits which are totally tax free. In this unit we will discuss the valuation of different types of perquisites.

At the end of 6th unit we have given you a chart and stated that under heads of income, certain deductions are allowed on account of expenses incurred to earn income thereunder. This permissible deduction is allowed before we arrive at the figure of taxable income under a particular head. Under this head, that is salaries, also deductions are allowed.

We have seen elsewhere that generally all employees are members of provident funds. Provident funds are formed out of contributions from employees and employers. The amount so collected is invested in government securities or in approved securities which earn interest. This interest is credited to the provident fund account of the employee. Provident fund is refunded to him when he retires from service or when he leaves it. We explain all these aspects in this unit.

8.2 VALUATION OF PERQUISITES

Perquisites are of two types. One type of perquisites which are taxable in all cases irrespective of the status of the employee and the amount drawn by him under the head 'Salaries'. The other type of perquisites are taxed only in specified cases. We will discuss valuation of both types of perquisites.

Valuation of Perquisites - Taxable in all Cases

i) Rent free accommodation

Rent free accommodation is taxable in all cases. So is the case with concession in rent. Salaried assesseees are classified into three categories with a view to valuing rent-free accommodation. The method of valuation depends on the type of categories of employees enjoying the perquisite.

Government Employees

Government employees include the employees of the Central and State Governments. Government employees deputed to an undertaking or body under the control of the Government are also covered in this category.

Valuation

Valuation of rent free accommodation in this case depends on what the Government is charging for this type of accommodation in the case of other employees. Government is free to charge any amount for any type of accommodation. In case of furniture, which includes refrigerator, television set, radio, air-conditioner, etc., is also provided in the house, 10 percent of the value thereof is included in the value of the house. In case the furniture is obtained on hire, charges paid will be included in the value of the house.

Semi-Government Employees

In this category the following are included :

- a) Persons employed by the Reserve Bank of India.
- b) Persons employed by a statutory corporation or a company owned by the Government or the Reserve Bank of India or both.

- c) Persons employed by a body or undertaking financed wholly or mainly by the Government.
- d) Officers of Government whose services have been lent to a company in which 40% or more shares are held by the Government and/or, Reserve Bank of India or a corporation owned by the Bank.

Valuation

Unfurnished accommodation will be valued at the rate of 10 percent of salary or fair rental value of the accommodation - whichever is less. Where furniture has also been provided, 10 percent of the cost of furniture will be added to the value of accommodation. Furniture includes refrigerator, television set and other household furniture. Where the furniture has been obtained on hire by the employer, the hire charges paid will be the value for the furniture to be added to the value of perquisite arrived at earlier. Thus for a furnished accommodation the value will be determined as follows:

- (a) 10 percent of salary or fair rental value of the house - whichever is less; plus.
- (b) 10 percent of the cost of furniture or hire charges payable by employer.

Employee in Private Sector

The employees who are not covered by the earlier two categories will naturally be covered here. All employees working anywhere in the private sector will come in this category.

Valuation

The following method is adopted for valuing rent free accommodation :

- (a) Where the rental value is less than 10 percent of salary, the rental value of the accommodation will be added to salary as the value of rent free accommodation.
- (b) Where the rental value is more than 10 percent of salary but does not exceed 50 percent of salary, only ten percent of salary will be the valuation of the house.
- (c) Where the fair rental value/annual value exceeds 50 percent of salary, then the value of the house will be determined as follows:
 - (i) 10 percent of salary, plus
 - (ii) Excess of fair rental value over 50 percent of salary.

In case the employee resides in Bombay, Calcutta, Delhi or Madras excess of fair rental value/annual value over 60 percent will be added instead of 50 percent.

In case the accommodation provided by the employer is also furnished by the employer 10 percent of the cost of furniture will also be added to the value of the house arrived at above. Where the furniture has been obtained on hire, hire charges will be the value of furniture.

ii) Residential Accommodation at Confessional Rate

Where the accommodation has been provided by the employer at confessional rate, the valuation of the house will first be found out on the lines given above. Out of the value so determined according to rules, the rent payable by the employee will be deducted and the balance will be the valuation of concession in rent.

VALUATION AT A GLANCE

Categories	Unfinished House	Furnished House
Government employees both Central and State	(a) Whatever amount is charged by the government for similar accommodation as per rules, that amount will be the value of perquisite. (b) If the same is payable by the employee-the value will be nil (c) If less amount is paid the difference will be taxable.	(a) 10% of the cost of furniture is added. (b) If it is hired, the hire charges will be included.
Semi-Government employees / Reserve Bank of India, Statutory corporations, University employees, etc.	(a) 10% of salary or fair rental value of the accommodation whichever is less. (b) If the employee pays less than 10%, the concession is taxable.	(a) 10% of the cost of furniture is added. (b) If it is obtained on hire, then the hire charges are added.
Employees in Private Sector	(a) Fair rental or 10% of salary, which-ever is less. (b) If the fair rental value exceeds 50% of salary, excess over 50% will be added to 10% of salary.	(a) 10% of the cost of furniture is added. (b) If it is obtained on hire, then hire charges will be added.

(c) In the case of Bombay, Calcutta, Delhi or Madras, excess over 60% will be added to 10%.

Salary for these calculations

For the purpose of valuation of perquisite in respect of rent-free accommodation salary includes:

- a) Basic Salary;
- b) Dearness Allowance/Pay, if terms of employment so provide;
- c) Bonus;
- d) Commission;
- e) Fees;
- f) All other taxable allowances (excluding amount not taxable).
- g) Income / Professional Tax paid by the employer on behalf of his employee (CIT Vs Denis, 1981, Bombay); and
- h) Electricity/gas/water expenses paid or reimbursed by an employer to his employee (CIT Vs Steel, 1972, Kerala).

For this purpose salary does not include the following :

- a) Dearness Allowance/Pay, if not taken into account while calculating retirement benefits like Provident Fund, gratuity, etc., or if terms of employment does not so provide;
- b) Employer's contribution to provident fund account of an employee;
- c) All allowances which are exempt from tax;
- d) Entertainment allowance to the extent deductible from salary u/s 16 (ii); and
- e) Value of Perquisites.

Illustrations

1. Dr. Chowdary is working as Financial Controller with the State Trading Corporation of India, Bombay on monthly salary of Rs. 3,500. He also enjoys the facility of fully furnished rent-free quarters. Dr. Chowdary is in receipt of a special allowance of Rs. 750 per month from the bank. The accommodation was furnished by the bank about five years ago at a cost of Rs. 80,000. You are required to find out the salary of Dr. Chowdary.

Solution

	Computation of Total Salary		Rs.
Salary			42,000
Special allowance			9,000
Value of rent free furnished house :	Rs.		
10% of salary for unfurnished	5,100		
10% of the cost of furniture	8,000	13,100	
	<u>Total Salary</u>	<u>64,100</u>	

2. Mr. Rangarao is employed with Sunsip Limited on a salary of Rs. 7,000 per month with Dearness Allowance of Rs. 1,000 per month. He is also entitled to bonus, equivalent to two months salary. Medical expenses reimbursed by company amount to Rs. 8,000 for the whole year. The ITO admits Rs. 5,000 only being genuine. Mr. Rangarao has been provided with a rent-free furnished accommodation by the company. Furniture provided in the quarters had cost the company Rs. 70,000 about three years ago. You are required to calculate his salary.

Solution

	Computation of Total Salary		Rs.
Salary			84,000
Dearness allowance			12,000
Bonus (2 months salary)			14,000
Medical expenses reimbursed :			
excess over Rs. 5,000 (8,000-5,000)		3,000	
Valuation of rent free accommodation :	Rs.		
10% of salary (84,000 + 14,000)	9,800		
10% of the cost of furniture	7,000	16,800	
	<u>Total Salary</u>	<u>1,92,800</u>	

Note

1. Salary for valuing rent-free accommodation includes bonus and other allowance but not dearness allowance. Where dearness allowance is included in salary for computing retirement benefits, it is included in salary for valuation too.

2. Bonus is generally calculated on the basic salary.
3. Medical expenses reimbursement is tax-free up to Rs. 5,000, having been admitted by the ITO. Excess is taxable
4. Since fair rental value of the accommodation is not given in this case, 10% of salary itself will become value of the perquisite.

Valuation of Perquisites Taxable in Specified Cases

We have seen earlier that there are certain perquisites which are taxable only in specified cases, namely those deriving by way of monetary emoluments of an amount exceeding Rs. 24,000, director or a person having substantial interest in the organisation. These perquisites are not taxable in other cases. For example, if the employer allows free use of car by the employee the perquisite will be taxable only if the salary of the employee exceeds Rs. 24,000 or if he is a director or a person having substantial interest in the organisation.

The valuation given here under is according to Income-Tax Rules and as per instructions issued by the Board from time to time.

i) Motorcar

- (a) *Owned by the employer and exclusively used by the employee:* Where the car is provided by the employer for use by the assessee exclusively for his private and personal purposes, the expenses met by the employer for maintenance and running of the motor car including normal wear and tear thereof will constitute taxable perquisite. Remuneration paid to the chauffeur will also be included.
- (b) *Owned by the employer and meant for official use only:* When the car provided by the employer is used only for official purposes, it shall not be treated as a perquisite because the employee is not deriving any personal benefit out of it.
- (c) *Car provided by the employer and used partly for office and partly for private purposes:* Sometimes the car provided by the employer is used partly for private purpose and partly for the discharge of his official duties. In such cases the valuation of this perquisite will be on the following lines.
 - (i) Where the motor car is owned or hired by the employer and all the expenses on maintenance and running are met or reimbursed to the assessee by the employer, then Rs. 300 p.m. for a car not exceeding 16 h.p. rating or less and Rs. 400 per month when the car is of more than 16 h.p.
 - ii) Where the motor car is owned or hired by the employer, but the expenses on maintenance and running for the assessee's private or personal purposes are met by the assessee, then Rs. 100 p.m. for a car of 16 h.p. rating or less and Rs. 150 p.m. when the car is of more than 16 h.p.

Where a Chauffeur is also provided to run the motor car, the value of the perquisite as calculated above shall be increased by a sum of Rs. 150 per-month.

- (d) *Where the employee uses more than one car:* Sometimes the employer maintains a pool of different cars and the officers are free to make use of any of these cars as and when needed. Here also the perquisite will be valued as above. However, if the h.p. rating of any of these cars exceeds 16, and the employee uses it, the value will be computed as if the employee had been provided with such a motor car. Rs. 150 p.m. will be added for chauffeur, if provided.
- (e) *Car owned by the employee:* Where the car is owned by the employee but the actual running and maintenance charges, of the chuffeur, if any are met or reimbursed to him by the employer, the value of the perquisite to the assessee shall be determined as the sum actually expended by the employer, which in the opinion of the I.T.O. can reasonably be attributed to the use of car by the assessee for private purpose. It is taxable in all cases.
- (f) *Motor car provided at a concessional rate:* The value of a motor car provided for the use of the assessee for private purposes at a concessional rate shall be determined as a sum by which the value compound according to the above rules exceeds the amount actually payable by the assessee to the use of such car, for the period of use during the relevant previous year.
- (g) *Any other conveyance:* Where any other conveyance is provided by the employer, its value will be determined by the Income-Tax Officer after estimating the expenses attributable to its use for private purposes.

ii) Gas, Electricity, Water

Sometimes the employer provides gas, electricity and water to employees free of cost. It also forms a perquisite. In case the employer provides these items out of his own resources then the value of these items will be taken to be nil. However, if the employer procures them from outside agency and then provides them to his employees, the actual cost incurred by the employer for getting these items will be the value of the supplies made to employees.

There may arise a situation where the assessee has to make use of such facilities to some extent for discharge of his official duties and the I.T.O. is satisfied in this regard. In such cases either the actual cost incurred by the employer in this regard or 6.25 percent of salary (whichever is less) will be the value of the facility.

iii) Free Education

Where the employer has been incurring some amount on extending educational facilities to the members of the employee's family, the amount incurred by him will be the taxable value of perquisite in the hands of the employee. In case, however, the educational institution is run by the employer himself the amount incurred by others in such educational institutions will be the value of the perquisite. For example, employer X spends Rs. 1,000 per month in educating children of employee A; Rs. 1,000 per month will be a taxable perquisite in the hands of A if he is a specified employee. On the other hand his two children get education in a college run by the employer without paying any charges. Other children on an average pay Rs. 150 per month. In this case, Rs. 300 per month will be the taxable value of perquisite on account of children's education.

iv) Free Transport

Transport facilities provided by the employer free of cost to the employee or the members of his family will be nil if the means of transport are owned by the employer. However, in case the employer has to obtain the transport facilities for use by the employee the amount paid for such facilities will be the taxable value of transport perquisite.

v) Perquisites of Hotel Employees

Where the hotel employees are staying in the hotel itself and taking food free of cost, the valuation shall be determined as follows :

- (i) Lodging : 10% or $12\frac{1}{2}$ % of salary for unfurnished and furnished accommodation respectively.
- (ii) Boarding : Actual cost of boarding including overhead as per accounts prepared by the hotel. The benefit is available only to the bonafide employees and not to the persons who have a substantial interest in the company or its directors, etc.

vi) Sweeper and Watchman

The Sweeper and Watchman provided to the employee free of cost will be a perquisite and therefore taxed. For a sweeper 75% of the actual wages or Rs. 60 per month (whichever is less) will be added whereas for a watchman 50% of the wages paid or Rs. 60 per month (whichever is less) will be the value for taxation.

vii) Free Gardener

Where the gardener is employed by the employee and the employer pay his salary, it will be taxed in the hands of all types of employees irrespective of his emoluments. On the other hand, if the gardener is employed by the employer and his services are made available to the employee, the treatment will be as follows:

- (a) *Where the Accommodation is a hired one:* If the employer has hired a house for his employee and he also provides the services of a gardener, the salary paid to the gardener will be taxable in the hands of specified employees only, that is, directors, etc.
- (b) *Where the accommodation is owned by the employer:* In case the accommodation is owned by the employer himself and then he provides the services of a gardener free of charge, then the salary paid by the employer will be included in deciding the rental value of the house. For example, the municipal value of a house is Rs. 5,000 and a gardener is paid an annual salary of Rs. 1,800; then the fair market value of the house shall be taken to be Rs. 6,800 and not Rs. 5,000 only. It is done in all cases irrespective of the salary of the employee.

Check Your Progress - 1

Mr. Sudeep, a senior private company executive in Bombay, provides the following information in respect of his income for the AY 1992-93.

- i) A salary Rs.56,000
- ii) Rent-free furnished accommodation, on which the company pays an annual rent of Rs.15,000. Cost of furniture in the house is Rs.20,000. Monthly lease rent for refrigerator in the house paid by the employer is Rs.200 p.m. Compute the value of Rent free home.

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Check Your Progress-2

List out perquisites taxable in specified cases only.

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8.3 STANDARD DEDUCTION [SECTION 16 (I)]

At this stage you are now in a position to find out the gross salary by adding up all amounts the employee has received as basic salary or by way of various allowances, or perquisites. You also have been told as to how the various perquisites have to be valued. Once you know all these figures, you add them up and the amount arrived at is the 'Gross Salary'.

As has been stated earlier, the employee is expected to incur certain expenses in the process of earning of salary and therefore, there should be allowed a deduction for such expenses. The Income-Tax Act takes a liberal view of the account keeping by the employee and allows a certain deduction in a standard way. The deduction so allowed is known as standard deduction and is allowed to all the employees whether they have incurred such expenditure or not.

Standard deduction of a sum equal to $33\frac{1}{3}$ percent of the salary or Rs. 12,000; whichever is less is allowable. Thus the maximum deduction allowed from salary is Rs. 12,000. This limit has been raised to Rs. 15,000 in respect of working women whose total income before making this deduction does not exceed Rs. 75,000 w.e.f. A.Y. 1993-94.

'Salary' for this purpose shall mean the gross salary composed of various amounts but does not include the exempted amounts under section 10. For example exempted amount of gratuity, house rent allowance, commutation of pension etc., should not be included. It includes fees, commission, perquisites or profit in lieu of or in addition to salary.

Where a person retires from service in the course of a previous year, the standard deduction will be calculated only with reference to the salary due to him for the period of his employment during the previous year. In other words it is the amount of salary received or due in the previous year that will decide the standard deduction and not the duration of employment.

Other Deductions

Entertainment allowance u/s 16(ii) as explained in the previous unit and actual amount of Tax on employment (Professional Tax) paid u/s 16(iii) are the other deductions allowed from Gross Salary in addition to Standard Deduction.

Check Your Progress - 3

What is the rate of standard deduction?

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8.4 PROVIDENT FUNDS

Provident Fund is a labour welfare scheme under which an employee is asked to save something for the future. Whatever amount is saved by the employee is deposited and an equal amount from the employer is also recovered for depositing in the provident fund account. Both these amounts are invested to earn interest which again is credited to the employee's account. The balance standing to the credit of the employee is handed over to him when he retires or at the time of leaving service. In case of death of the employee, the amount is handed over to his nominee. Thus the provident fund account at any point of time consists of the employee's contribution, the employer's contribution, and the interest on both. Since it is a saving for old age, there are provisions in the Income-Tax Act to encourage this type of savings. We will discuss all such provisions hereunder.

Provident funds maintained by the employers are of three types (a) Statutory Provident Fund, (b) Recognised Provident Fund; and (c) Unrecognised provident Fund.

The employees in public sector or with State Government or Central Government have two types of Provident Funds (a) Contributory Provident Fund, and (b) Government Provident Fund.

For those persons who are not members of any of the provident funds or those who are interested in saving something more, another type of provident fund has been provided, namely

Public Provident Fund.

Statutory Provident Fund

Statutory Provident Funds are managed according to the Provident Funds Act, 1925. They are found with employers in the public sector, autonomous bodies, local self government office, universities, etc.

Recognised Provident Fund

Provident Fund which is recognised by the Commissioner of Income-Tax is known as recognised provident fund. The Commissioner of Income-Tax will recognise the provident fund only when the employer complies with the conditions laid down in Part A of the Fourth Schedule to the Income-Tax Act, 1961.

Provident Funds established under the provisions of the Provident Fund Act, 1952 are included in this category. They are found in the concerns in the private sector.

Unrecognised Provident Fund

The Provident funds which do not comply with the requirements of the provisions of Part A of the Fourth Schedule to the Act remain unrecognised. They are maintained by firms which are not in the organised sector.

Public Provident Fund

Public Provident Fund has been started by the Central Government to which any assessee or person could subscribe. It earns interest at the rate prescribed by the Government from time to time. The amount deposited in the fund along with the interest earned could be back after 15 years, from the end of the financial year in which the account has been opened. For the financial year 1987-88 interest credited to the account was at the rate of 12 percent per annum.

Contributory Provident Fund (CPF) and Government Provident Fund (GPF)

Government employees are members of these funds. They are maintained by the Government. Contributory provident fund is a fund which operates in case of employees who are not eligible for pension. These funds are maintained on the lines of any other provident fund like Statutory provident fund. The employees who are eligible for pension benefit may become members of the Government Provident Fund to which the employer will not contribute anything. The contribution by the employees is kept in the account which earns interest thereon. The amount is refunded to the employees on retirement etc.

8.5 INCOME-TAX PROVISIONS AND PROVIDENT FUNDS

Statutory Provident Fund

- (a) Employee's contribution to statutory provident fund qualifies for tax rebate under Section 88.

- (b) Employer's contribution thereto is not considered at all because it is not taken to be the income of the employee during the course of employment.
- (c) Interest earned thereon is also ignored.
- (d) Refund therefrom is not taken to be income of the employee and therefore, is not taxed.

Recognised Provident Fund

- (a) Employee's contribution qualifies for tax rebate under Section 88.
- (b) Employer's contribution is not considered upto 10% of salary, excess over this limit is included in salary and taxed.
- (c) Interest earned thereon is ignored only upto 12% in rate. Excess of interest over this limit is included in salary and taxed.*
- (d) Refund from the fund is tax-free and not included in total income provided the following conditions are fulfilled :
 - (i) The employee has rendered service for a continuous period of five years.
 - (ii) Where he has left the service before completing five years, the reasons for leaving must be beyond his control.

Unrecognised Provident Fund

- (a) Employee's contribution to this fund does not qualify for any rebate and therefore, it is ignored.
- (b) Employer's contribution to Unrecognised Provident Fund is not considered year after year and, therefore, left out at the time of annual assessment.
- (c) Interest credited to employee's account in this provident fund is also not considered every year and so ignored.
- (d) Refund from this fund at the time of retirement or leaving of service is broken into two parts. One the employee's contribution year after year and interest accrued thereon, and second, the amount representing the employer's contribution and interest thereon. It is the employer's contribution and interest thereon which is included in salary and taxed. Interest allocable to employee's provident fund contribution is included under 'income from other sources' and taxed.

*Till 17-6-1985 the rate was 10%. It was raised to 10.5 w.e.f. 18-6-85 and to 12% during the year.

Public Provident Fund

- (a) Assessee's contribution to this provident fund qualifies for tax rebate under Section 88.
- (b) There is no contribution to this fund from the Government.
- (c) Interest on this provident fund is completely tax-free and is not considered at all.
- (d) Refund from this is not at all taxed.

Contributory provident Fund and Government Provident Fund

- (a) Employee's contribution to CPF or GPF qualifies for tax rebate under Section 88.
- (b) Employer's contribution of CPF is ignored. Government does not contribute anything to the GPF.
- (c) Interest credited to both of them is not considered as income and therefore, ignored.
- (d) Refund from these provident funds is also not income.

Approved Superannuation Fund

Superannuation in common language, means retirement. A fund which is created to be paid back to the employee at the time of superannuation and which has been approved by the Commissioner of Income-Tax is known as Approved Superannuation Fund. Contribution to an Approved Superannuation Fund qualifies for tax rebate under Section 88 like any other contribution to provident fund.

8.6 COMPUTATION OF SALARY INCOME AND ITS DEDUCTIONS

To summarise the salary income is to be computed as follows:

I. Items to be included (Sec.17)

I. Salary :

i)	Wages	...	
ii)	Fees	...	
iii)	Pension	...	
iv)	Annuity	...	
v)	Taxable amount of gratuity	...	
vi)	Taxable amount of leave salary	...	...

II. Cash Allowances and Payments :

i)	Dearness Allowance	...
ii)	Taxable portion of House Rent Allowance	...
iii)	Entertainment Allowance	...
iv)	Taxable portion of Conveyance Allowance	...

III. Perquisites :

i)	Value of Free or Concessional Accommodation	...
ii)	Value of Free or Concessional Benefits or Amenities, such as, Conveyance, Gas, Electricity, Domestic Servants, Education for children, Transport, Insurance Premium or Income-Tax, Lunch, Hotel Bills, etc., paid by Employer, value of interest on loan given interest-free or at lower rate of interest	...

IV. Profits in lieu of Salary :

i)	Taxable portion of compensation on voluntary retirement, termination or dismissal from service.	...
ii)	Taxable portion of Employer's contribution to Recognised Provident Fund and interest accruing on the accumulated balance in Recognised Provident Fund, etc.	...
iii)	Transferred Balance	...

II. Items to be deducted [Sec.16(i)(ii)(iii)]

i)	Standard Deduction	...
ii)	Entertainment Allowance	...
iii)	Tax on Employment	...

Chargeable Income from Salaries

Check Your Progress - 4

From the particulars of Sri Reddy given below, you are requested to compute his salary income for the assessment year 1992-93.

1. Basic salary Rs.20,000
2. High cost of living allowance - 20% of salary
3. Entertainment allowance, Rs.5,600.
4. Conveyance allowance Rs,6,000.
5. Family allowance Rs.1,500.
6. Profit bonus at 30% of salary
7. Rent-free unfurnished accommodation with a fair rental value of Rs.2,000 p.a.

The other details are as follows :

- i) He contributes at 12% to an unrecognised provident fund.
- ii) He pays LIC premium amounting to Rs.4,000/- (the sum assured is Rs.50,000).
- iii) 20% of conveyance allowance is used for personal purposes.
- iv) Prior to 1st April 1955, he used to get entertainment allowance at Rs.250 p.m.

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8.7 QUALIFYING AMOUNT AND REBATE OF TAX

We have elsewhere stated the incentives available for savings if they have been invested in approved channels. All savings invested in approved channels qualify for rebate of tax under Section 88.

According to Section 88 the approved channels are Provident Fund Contribution, Life Insurance Premium, National Saving Certificates, etc.

You will have to remember one more limitation. Life Insurance paid on any policy should not exceed ten per cent of the amount insured. Where the premium exceeds ten per cent of the capital sum assured, the excess is ignored. For example, where the assessee pays Rs. 5,000 on a policy of Rs.40,000 the qualifying premium will be restricted to Rs.4,000 only.

Rate of Rebate in Respect of Qualifying Amount

We are discussing Section 88 in unit number 20. However, it will be relevant here to have an idea of the rate of rebate of tax in respect of qualifying amount. You should remember that the whole qualifying amount is not rebatable. It is only at the following rates applicable to qualifying

amount the deduction is available from gross tax payable:

- (a) 20% of qualifying amount subject to a maximum of Rs.10,000 for ordinary individuals. This is raised to Rs.12000/- w.e.f. A.Y. 1993-94.
- (b) 20% of qualifying amount subject to a maximum of Rs.14,000 in respect of individuals like actors, singers, authors, playwrights, etc. This limit is raised to Rs.17,500/- w.e.f. A.Y. 1993-94 subject to certain conditions.

8.8. ILLUSTRATIONS

1. Shri P.K.Nair is an accountant in a firm in Madras. He has furnished the following information of his salary income for the financial year 1991-92.

Basic salary Rs.40,000 : Dearness Allowance Rs.21,400 : City Compensatory Allowance Rs.4,500 : House Rent Allowance Rs.10,000.

Nair has contributed to a Provident Fund 12% of his basic salary to which the employer has also contributed at Rs.12%.

Shri Nair has spent Rs.800 on the purchase of books necessary in connection with his job. He is living in a rented house paying Rs.1000 p.m. as rent. He has also paid Rs.5,000 by way of life insurance premium on his own life during the year, the amount of the policy being Rs.40,000.

You are required to compute the total income of Nair if he contributes to :

- (a) a statutory provident fund
- (b) recognised provident fund, and
- (c) unrecognised provident fund

Solution

(a) Statutory provident Fund

		Rs.
Basic Salary		40,000
Dearness Allowance		21,400
City Compensatory Allowance		4,500
House Rent Allowance	10,000	
(-) Exempted amount	8,000	2,000
	<u>Gross Salary</u>	<u>67,900</u>
Standard deduction at 33 1/3% or Rs. 12,000 whichever is less		12,000
Taxable salary being Gross Total Income/Taxable Income		<u>55,900</u>

Qualifying amount for Rebate of tax U/S 88 :

Contribution to Statutory Provident Fund	4,800
Life Insurance premium being restricted to 10% of sum assured	4,000
	<u>8,800</u>

(b) Recognised Provident fund

	Rs.	Rs.
Basic Salary		40,000
Dearness Allowance		21,400
City Compensatory Allowance		4,500
House Rent Allowance	10,000	
(-) Exempted Amount	<u>8,000</u>	2,000
Excess of employer's contribution to Recognised provident fund in excess over 10% (4,800-4,000)		800
Gross Salary		<u>68,700</u>
Standard deduction		12,000
Net salary being Gross Total Income/Taxable Income		<u>56,700</u>

Qualifying amount for Rebate of Tax U/S 88:

Contribution to R.P.F. at 12%	4,800
Life Insurance premium being restricted to 10% of the sum assured	4,000
	<u>8,800</u>

(c) Unrecognised Provident Fund

	Rs.	Rs.
Basic Salary		40,000
Dearness Allowance		21,400
C.C.A.		4,500

House Rent Allowance	10,000	
(-) Exempted amount	8,000	2,000
Gross salary		<u>67,900</u>
Standard deduction		12,000
Net salary being Gross Total Income/Taxable income		<u>55,900</u>
Qualifying amount for Rebate of Tax U/S 88 :		
Life Insurance premium being restricted to 10% of the sum assured	<u>4,000</u>	

Note:

1. Deductible amount in respect to house rent allowance has been calculated as below.

	Rs.
(i) Actual House Rent received	10,000
(ii) 50% of salary (Madras)	20,000
(iii) Excess of rent paid over 10% salary (12,000-4,000)	8,000

Whichever is less, that is Rs.8,000 will be exempted in this case.

2. Life Insurance premium is restricted to 10 per cent of the sum assured that is 10 per cent of Rs. 40,000. Rs. 4,000 will therefore qualify.
2. From the particulars of Mr. Sathyanarayana Murthy given below you are requested to compute his total salary for the Assessment Year 1992-93.

(1) Basic salary Rs. 30,000 (2) High Cost of Living allowance 20% of salary (4) Entertainment allowance Rs. 7,000; (5) Conveyance allowance Rs. 7,000; (6) Family allowance Rs. 5,000; (7) Profit Bonus at 30% of salary; (8) Rent free unfurnished accommodation with a fair rental value of Rs. 3,000 p.a. The other particulars are:

- (i) He contributes at 12% to an Unrecognised Provident Fund.
- (ii) Pays Life Insurance premium amounting to Rs. 7,000, the capital sum assured being Rs. 80,000.
- (iii) 80% of the conveyance allowance was stated to have been spent in discharging official duties.
- (iv) Prior to 1st April, 1955 Mr. Murthy used to get entertainment allowance at Rs. 450 per month.

Solution

	Rs.	Rs.
(i) Basic Salary		30,000
(ii) High Cost of living allowance		6,000
(iii) Entertainment allowance		7,000
(iv) Conveyance allowance	7,000	
Less : attributable to official duties	<u>5,600</u>	1,400
(v) Family allowance		5,000
(vi) Profit bonus at 30% of salary		9,000
(vii) Rent-free accommodation		<u>3,000</u>
		61,400

Gross Salary

Less : Standard deduction	12,000	
Entertainment allowance	<u>5,400</u>	17,400
Net Salary		<u>44,000</u>

Qualifying amount for Rebate of Tax U/S 88

Life Insurance premium Rs.7,000

Note: Employee's contribution to the provident fund does not qualify for rebate as it is unrecognised.

3. Mr. Mukherjee is a general manager of a company in Delhi and draws Rs. 5,500 p.m. He is provided with a house for which the company pays Rs. 16,000 p.a. as rent. Furniture and fittings costing Rs. 50,000 are also provided. The company bears electric charges which average Rs. 150 p.m. and it also employs a gardener on Rs. 75. He along with officers of the company, is provided with free lunch in the office on all working days. He contributes Rs. 1,000 p.m. to R.P.F. and Rs. 150 to the Approved Superannuation Fund, the company contributing equal amount. Interest credited to his P.F. account for the previous year is Rs. 7,200. Compute the salary income of Mr. Mukherjee for the previous year ended on 31st March, 1992 after taking into account the following information:

- Mukherjee claims that a part of his house is used by the customers of the company during their business visits. The A.O is agreeable to treat 1/4th of the house being used for the company purpose.
- He has been drawing entertainment allowance at the rate of Rs. 400 p.m. from

1-2-1955, Rs. 600 p.m. from 1-4-1960 and Rs. 750 p.m. from 1-4-1964.

Solution

	Rs.	Rs.
Salary		66,000
Valuation of rent free house:		
10% of salary (66,000+4,200)	7,020	
Excess of rent over 50% of salary (12,000-35,100)	—	
	<u>7,020</u>	
Other amenities		
10% of Rs. 50,000	5,000	
Electric charges	1,800	
Gardener	<u>900</u>	
	7,700	
Less one fourth	<u>1,925</u>	
	5,775	12,795
Company's contribution to Recognised Provident fund exceeding 10% of Salary (12,000-6,600)		5,400
Entertainment allowance		9,000
Valuation of lunch facility, say Rs. 150 per month		1,800
Gross Salary		<u>94,995</u>
Deduction: Standard deduction	12,000	
Entertainment allowance	4,800	16,800
Net Salary		<u>78,195</u>

Note:

1. Since one-fourth of the accommodation provided by the employer is being used for official purposes, annual value of only three-fourth of the house will be relevant. Similarly, one fourth of the value of other amenities has also been deducted.
2. Deduction on account of the entertainment allowance has been calculated as follows:

- (a) Rs. 7,500 per annum
- (b) One-fifth of salary, Rs. 13,200
- (c) Entertainment allowance drawn before 1-4-1955, Rs. 4,800
- (d) Actual entertainment allowance Rs. 9,000;

Whichever is less, that is 4,800 will be deducted in this case.

8.9 SUMMING UP

The valuation of various perquisites is an important aspect in computing salary income. On the method of this valuation will depend the taxability of salary and therefore these provisions should be understood correctly. Important among the perquisites from the valuation point of view are rent free accommodation, free conveyance, free servants. Another important aspect in salaries is the treatment of different types of provident funds. These provisions are important from the practical point of view, because each one of the employees is concerned with the provident fund.

There are two deductions under the head salaries. They are standard deduction under section 16 (i) and entertainment allowance under section 16 (ii). Professional Tax (tax on employment) is also deductible. These are to be deducted from gross salary in order to get salary income.

The chart given at the end of this unit helps to understand at a glance some of the important items relating to the head 'Income from Salary'.

8.10 CHECK YOUR PROGRESS : MODEL ANSWERS

1. Valuation of Rent-free house in Bombay:

(Fair Rental value Rs. 15,000; salary Rs. 56,000)

10% of Salary	5,600
FRV over 60% of Salary	
(15,000-33,600)	Nil
Value of unfurnished house	5,600
(+) 10% of cost of furniture	2,000
(+) Lease rent (200 × 12)	2,400
Value of Rent Free House	10,000

2. (i) Motor Car (ii) Free Gas, Electricity, Water (iii) Free Education, (iv) Free Transport (v) Free domestic services like sweeper & watchman, Gardener.

3. $33\frac{1}{3}\%$ of salary subject to a maximum of Rs. 12,000.

4. Computation of salary income of Mr. Reddy for the Assessment Year 1992-93:

	Rs.	
Basic salary	20,000	
High cost of living allowance (20% of salary)	4,000	
Entertainment allowance	5,600	
Conveyance allowance (20% of 6,000)	1,200	
Family allowance	1,500	
Profit Bonus (@ 30% of salary)	6,000	
<u>Rent-Free unfurnished Accommodation</u>		
Value of rent free house	2,000	
(Fair Rental value Rs. 2,000 p.a. 10% of salary [20,000 + 2,600 (EA 5,600 - 3,000) + 1,200 + 1,500 + 6,000 = 31,300] Rs. 3,130 whichever is less is taxable.		
Gross Salary	40,300	
Deduction u/s 16		
i) Standard deduction Maximum	12,000	
ii) Entertainment Allowance:		
(Least of the following four items)		
i) 1/5 th of Salary = 4,000 (1/5 × Rs. 20,000)		
ii) Rs. 7,500		
iii) E.A. drawn at present = 5,600		
iv) E.A. drawn or before 1.4.55 = 3,000	3,000	15,000
Salary Income		25,300

8.11 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following in about 30 lines each:

1. Explain the term 'perquisites'. How are they taxed?
2. Describe tax free benefits.
3. What are the rules regarding the valuation of rent free accommodation provided to the employees?
4. Shri Gupta has been with Nagarjuna Private Ltd., on a salary of Rs. 5,000 per month with dearness allowance at Rs. 600 per month. He is eligible to three month's salary by way bonus.

He is allowed rent free house for which the company pay Rs. 2,000 per month as rent. He also claims medical reimbursement during the year of an amount of Rs. 8,000 and home leave concession for going home amount of Rs. 7,500. Calculate taxable salary of Mr. Gupta for the previous year 1991-92.

II. Short Questions

Answer the following in about 15 lines each:

1. Describe the provisions relating to unrecognised provident fund.
2. Calculate taxable salary in case of the following:
Mr. Naik is employed at Rs. 4,000 p.m. plus 400 p.m. as dearness allowance. He is permitted to use the office car for private purposes also. All expenses are paid by employer for running and maintenance of the car.
3. Miss Archana is employed with State Trading Corporation on a salary of Rs. 3,500 p.m. and dearness allowance of Rs. 600 p.m. She is provided with rent free accommodation with fair rental value of Rs. 10,000 per annum.
4. How would you deal with the following:
 - (a) Interest credited to recognised provident fund.
 - (b) Refund from unrecognised provident fund.
 - (c) Facility of car.
 - (d) Medical benefits

5. Describe provisions relating to recognised provident fund.
6. How would you value the following:
 - (a) Rent free accommodation in respect of Government employee.
 - (b) Free lunch provided to all employees
 - (c) Free education to employee's children.
7. Explain the following:
 - i) Public Provident Fund
 - ii) Standard deduction
 - iii) Entertainment allowance.

WHAT IS INCLUDED IN SALARY Under the head 'salary'

Table I

are taxed	Salary + Perquisites + Profits in Lieu of Salary
Salary u/s 17(1) includes	Wages, annuity or pension, gratuity, fees, commission, perquisites or profits in lieu of or in addition to salary, advances of salary, taxable amount of annual accretion and transferred balance.
Perquisites u/s 17(2) includes	Value of rent-free accommodation, concession in rent, sum paid for the obligation of the assessee, life insurance premium, any other amenity or benefit in specified cases.
Profits in lieu of salary u/s 17(3) includes	Compensation for termination of service, other payments excepting the exempted payments u/s 10(10), 10(10A), 10(10B), 10(11), 10(12) & 10(13A) and the payments received from the funds, etc. beyond the exempted limits.

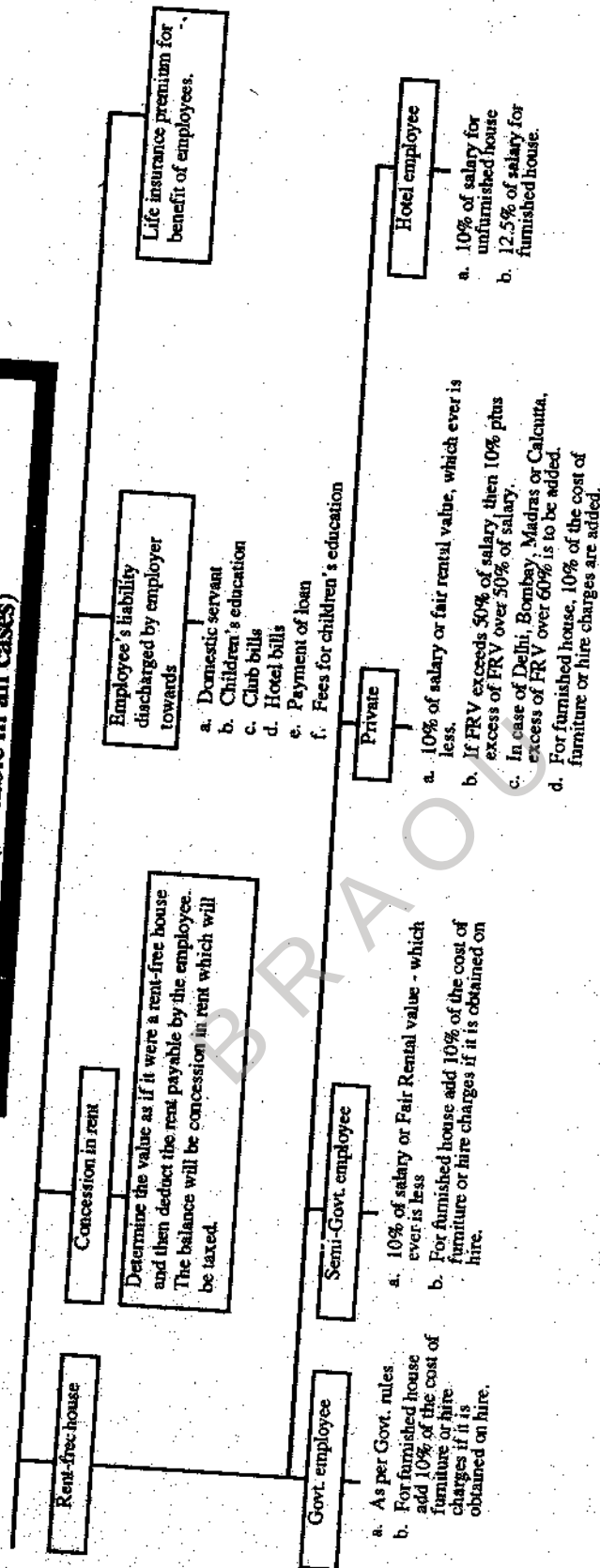
SALARY FOR DIFFERENT PURPOSES

Table II

1 Chargeability	2 Rent-free accommodation	3 House rent allowance	4 Entertainment allowance	5 Standard Deduction	6 Gratuity	7 Provident fund contribution	8 Perquisite u/s 17(2) (iii) (c), limit
a. Salary, wages b. Advance of salary c. Arrears d. Pension e. Annuity f. Gratuity g. Allowances h. Fees i. Transferred Commission j. Excess of employer's contribution to RPF over 10% k. Refund from UPF upto employer's contribution and interest thereon	a. Basic Salary b. Bonus c. Allowances d. Commission Not includible a. Dearness allowance unless it is included in salary for computation of retirement benefits b. Employer's contribution to PF. c. Tax-free allowance d. Exempted portion of entertainment allowance. e. Perquisites	a. Basic Salary b. Dearness allowance is included only when it is included for calculation of retirement benefits. All other allowances and bonus, should be excluded.	Only basic salary No allowances, perquisites or benefits included.	All inclusive but excluding the following: Payments received and exempt u/s 10(10), 10(A), 10(B), 12, and 13A).	a. Basic Salary b. Dearness allowance is included for calculation of retirement benefits, in short, same as in column 3.	Same as in column 6.	a. Basic Salary b. Dearness allowances c. Other allowances d. Bonus e. Commission f. All other monetary emoluments.

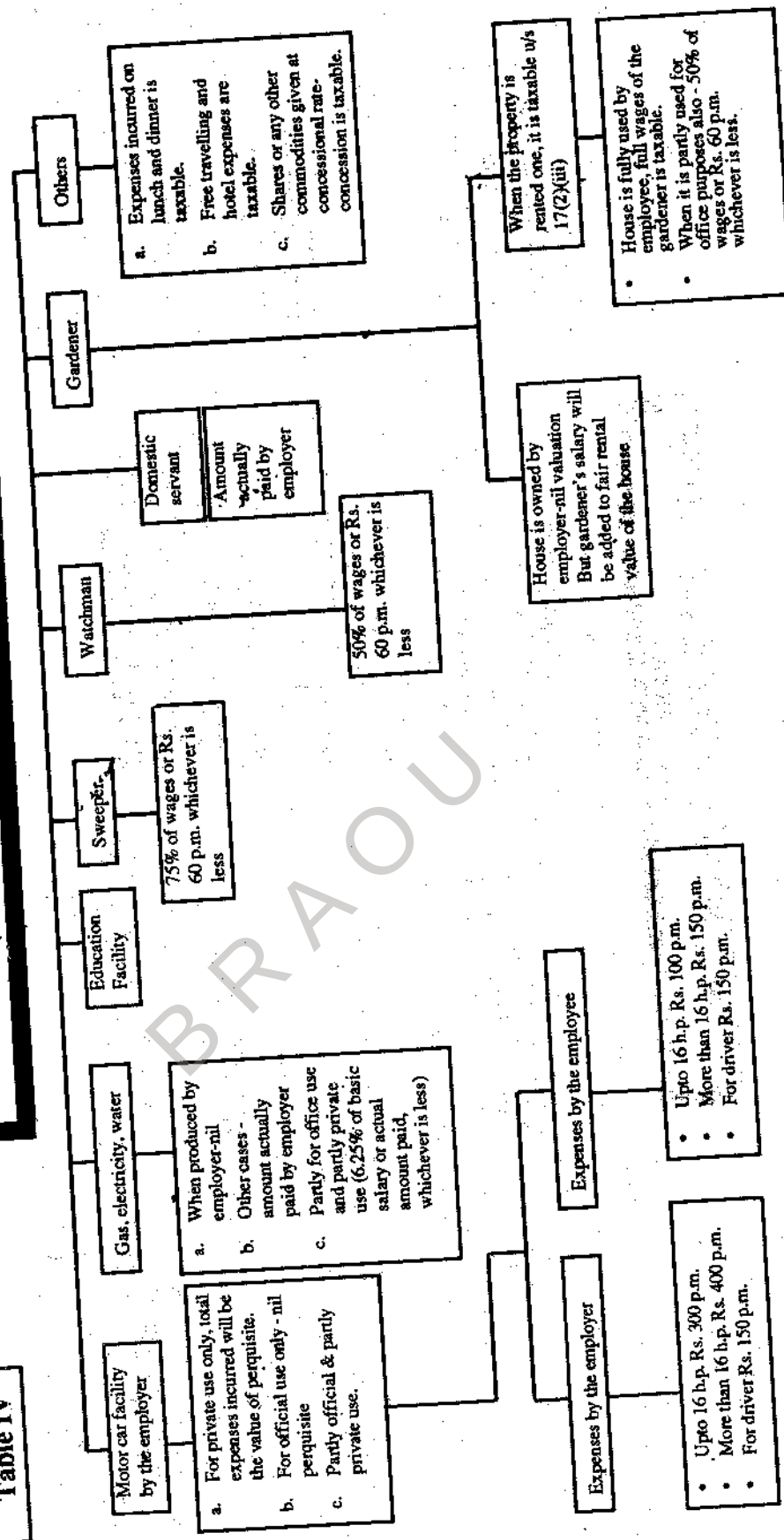
Table III

PERQUISITES AND THEIR VALUATION
(Taxable in all cases)



PERQUISITES AND THEIR VALUATION (Taxable in specified cases)

Table IV



UNIT - 9 : INCOME FROM HOUSE PROPERTY

[SEC.22 TO 27]

Contents

- 9.0 Aims and Objectives
- 9.1 Introduction
- 9.2 Chargeability
- 9.3 Characteristics of Income from House Property
- 9.4 Exclusions
- 9.5 Determination of Annual Value
 - 9.5.1 Rented Property
 - 9.5.2 Self Occupied Property
- 9.6 Deductions from Annual Value
- 9.7 Amount not Deductible
- 9.8 Loss under the Head
- 9.9 Co-ownership and Deemed owner of House Property
- 9.10 Computation of Income from House Property
- 9.11 Illustrations
- 9.12 Summing Up
- 9.13 Check Your Progress: Model Answers
- 9.14 Model Examination Questions

9.0 AIMS AND OBJECTIVES

The objectives of this unit are to discuss various aspects relating to income from House Property and to give you an idea about the computation of income chargeable under this head.

After going through the unit, you will be able to:

- describe the characteristics of income from House Property,
- list out exempted incomes from House Property,
- understand the determination of annual value,

- explain the deductions allowed from Annual value,
- compute income from House Property.

9.1 INTRODUCTION

Another important head of income is "Income from House Property". It is the second head of income and is important because generally most of the assessee's own houses whether they let or reside therein.

The term 'house property' has not been defined anywhere in the Act and therefore we have to depend on the various interpretations handled by the law courts in India and abroad. The relevant Sections in this regard are as under :

22. Income from house property.
23. Annual value how determined.
24. Deductions from income from house property.
25. Amounts not deductible.
- 25A. Special provision for cases where unrealised rent allowed as deduction is realised subsequently.
26. Property owned by co-owners.
27. Deemed Owner of house property

All these items are explained in this unit.

9.2 CHARGEABILITY

The annual value of property consisting of any buildings or lands appurtenant thereto, of which the assessee is the owner, shall be chargeable to income tax under the head 'income from house property'. Such property shall not include that property which the assessee may occupy for the purposes of any business or profession carried on by him, the profits of which are chargeable to income-tax. This is according to Section 22.

From a perusal of the above, we find that there must be a building owned by the assessee and then only the income therefrom is chargeable here. Income from land is not chargeable under this head unless the land is appurtenant to the building. Secondly, if someone hires the property for sub-letting and derives some income therefrom, he will not be chargeable to tax under this head. Thirdly, if the assessee uses his own house property for his business or profession, the income of which is chargeable to tax, there is no provision of taxing any notional income from such property.

9.3 CHARACTERISTICS OF INCOME FROM HOUSE PROPERTY

Building and Lands Appurtenant thereto

For bringing any income within the ambit of this head, there must be a building. Income from land let out in urban areas for storing etc., is outside the jurisdiction of this section. The term 'building' includes docks, warehouses or any other work where block of bricks, stone work, etc., are involved.

Annual Value

It is not the rent that is put to tax but it is the annual value which carries a special meaning which is important from the view point of taxing income under this head. The term 'annual value' has been defined in the Act.

Ownership

Another important aspect under this head is that the assessee must be the owner of house property if he has to pay tax under this head. Income from sub-letting of house property is not taxable under this head. It is, of course, taxed under the head 'income from other sources'.

House must not be used for Assessee's Business

Suppose the assessee is carrying on his own business in a house owned by him, then there is not question of taking any notional income from such a house. It is based on the assumption that if the assessee is asked to pay tax on such notional income, he will claim notional rent as business expenditure while computing taxable profits from the business. It is therefore, neither taken to be a notional income nor is rent allowed while computing taxable profits from business.

9.4 EXCLUSIONS

There are many incomes arising out of the house property which are not at all taxable and they remain outside the purview of the Income-Tax Act, 1961. Some of them have been discussed in earlier units. However, for the sake of clarity we propose to narrate them once again:

Property in the vicinity of Agricultural land

Income from property "in the immediate vicinity of the agricultural land" which is used as dwelling house, or a store house or other building by the cultivator, is agriculture in nature and therefore, not includible.

Property held for Charitable Purposes

Income from property held for charitable or religious purposes fall under Section 11. For example, rent from shop owned by Temples or Mosques etc., is not taxed.

Property used for own business

Income from property used for assessee's own business or profession.

Self-occupied house which could not be used [23 (3)]

Income from residential property in the occupation of the owner, if the owner could derive no benefit therefrom owing to his employment, business or profession being carried on at any other place.

Registered Trade Union [10 (24)]

Any income chargeable under the head 'income from house property' in the hands of a registered trade union is not taxable.

Marketing of Commodities [10 (29)]

In the case of authority constituted under any law for the time being in force for the marketing of commodities, any income derived from the letting of godowns or warehouses for storage processing or facilitating the marketing of commodities is exempted. It is a sort of incentive allowed to the authorities owning godowns, etc.

9.5 DETERMINATION OF ANNUAL VALUE

We have seen under the head 'Chargeability' that it is the annual value of the house property that is chargeable to tax. It is therefore, necessary to know as to how this annual value is to be determined.

Section 23 (1) is the first step in the determination of annual value of house property. Accordingly, the annual value of any property shall be deemed to be the following:

- (a) the sum which the property might reasonably be expected to be let from year to year, or
- (b) Where the property is let and the annual rent received or receivable by the owner is in excess of the sum stated in (a) above, the amount so received or receivable will be the annual value.

There is one more adjustment to be made in this regard, where the house property is subject to local taxes, and they are borne by the landlord, such local taxes are deductible in order to arrive at the annual value.

9.5.1 Rented Property

The annual value of the rented house property will be determined on the basis of the fair rental value or the rent received (whichever is higher) and the local taxes payable by the landlord are deductible.

Newly Constructed Residential House

We have earlier stated that the Income-Tax Act consists of certain incentives for house building activity. One such incentive is provided here.

Where residential units have been newly constructed and let out, the annual value will be

determined after allowing a deduction at a rate given below:

Construction has been started after 31.3.1982 and completed before 1.4.1992.	
Duration of Deduction	First 5 years
Amount of deduction per year	Rs. 3,600/- per residential unit or the annual value after deduction of local taxes, whichever is less.

Important Point

- (a) The deduction is available only when the residential units have been let out for residential purposes. In case the owner himself stays therein, deduction under this provision will not be available.
- (b) The deduction is available for a period of five years from the date of completion.

Note: This deduction is not available in respect of the buildings constructed after 31.3.1992 (Finance Act, 1992).

9.5.2 Self-Occupied House Property

- (a) A house or part of a house in the occupation of the owner for the purposes of his own residence and which is not let during any part of the previous year, the annual value of such house or part shall be taken as nil.
- (b) Where the house or the part is let during any part or parts of the previous year, the annual value will be reduced proportionately for the period during which it was occupied by the owner.
- (c) Where the owner keeps more than one house under his occupation, the treatment as stated above will be restricted to only one house opted by the assessee. Other houses under his occupation will be treated as if they had been let out.
- (d) Where the self-occupied property consists of only one residential house and it cannot be occupied by the assessee owing to employment, business or profession carried on at any other place and he was to reside at that place in a rented house, the annual value of such house shall be taken to be nil.

9.6 DEDUCTIONS FROM ANNUAL VALUE

Section 24 lists the following allowable deductions from Annual Value. We must remember that deductions under the following heads only will be allowed and under no circumstances any other item be considered for deduction.

i) Repairs

The owner of the house is supposed to spend money on repairs of the house. There is a straight deduction at the rate of one-sixth of the annual value as determined above. The deduction is allowed whether there are repairs or no repairs.

There may be a situation where the property has been let out and the tenant has undertaken to bear the cost of repairs. In that case the deduction on account of repairs will be as follows :

- (a) The excess of the annual value over the amount of rent payable for a year by the tenant; or
- (b) A sum equal to one-sixth of the annual value, whichever is less.

Note: A Composite standard deduction of one-fifth of the net adjusted annual value will be allowed in respect of repairs and collection charges w.e.f. A.Y. 1993-94 irrespective of whether tenant or land lord has undertaken to bear the cost of repairs.

ii) Insurance Premium

Any premium paid to insure the property against the risk of damage or destruction.

iii) Annual Charge

The amount of any annual charge where the property is subject to the same, provided such charge has not been created by the assessee voluntarily or is not a capital charge.

"Annual charge" means a charge to secure an annual liability, but does not include any tax in respect of property or income from property imposed by a local authority or the Central or a State Government.

iv) Ground Rent

Where the property is subject to ground rent, the amount thereof will be allowed.

v) Interest on Borrowed Capital

Where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital.

Expenses under (iii), (iv) and (v) stated above are allowed on the basis of accrual and they need not have been paid during the previous year. Their becoming due during the previous year is sufficient for allowability.

Explanation

Interest on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed shall be deducted in five equal instalments beginning from the year in which the completion or purchase has taken place.

To illustrate, X is constructing a house for which he has borrowed Rs. 5,00,000 from time to time during the construction period. The construction takes three years. It is completed in October, 1990. Interest on borrowed funds prior to October, 1990 comes to Rs. 50,000. Deduction in respect of this amount of Rs. 50,000 will be allowed in five equal instalments of Rs. 10,000 beginning from the previous year 1990-91.

vi) Land Revenue

Any sums paid on account of land revenue in respect of the property.

vii) Collection charges

Any sum spent to collect rent from the property not exceeding 6% of the annual value of house property.

Note: It may be noted that rate of 6% will be applied to the annual value after deduction of municipal taxes irrespective of the vacancy allowance.

viii) Vacancy Allowance.

Where the property is let and remains vacant during a part of the year, that part of the annual value which is proportional to the period during which the property is wholly unoccupied or where the property is let out in parts, that portion of the annual value appropriate to any vacant part which is proportionate to the period during which such part is wholly unoccupied.

Where the house remained vacant throughout the year there is no question of allowing vacancy allowance. In that case, the annual value of the house will be nil.

ix) Unrealised Rent

Subject to the rules given below, the amount in respect of rent from property let to a tenant which the assessee cannot realise is deductible.

Rules for deduction of unrealised rent: Deduction shall be allowed for such part of income in respect of which tax is payable under the head "Income from House Property" as is equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrecoverable where :

- (a) The tenancy is bonafied :
- (b) The defaulting tenant has vacated or steps have been taken to compel him to vacate the property;
- (c) The defaulting tenant is not in occupation of any other property of the assessee;
- (d) All reasonable steps have been taken to recover the amount but in vain. Alternatively the Income-Tax Officer has been convinced that legal proceedings will be fruitless.
- (e) The deduction shall be limited to the total income under this head without allowing this deduction.

Deduction in respect of self-occupied property

No deduction will be allowed in respect of the self-occupied property where the annual value has been taken to be nil. However, if in respect of this house some interest has been paid on borrowed capital, an amount by way of interest upto Rs. 5,000 could be allowed. Under such circumstances the self-occupied house will yield loss which will be set off against other income.

Check Your Progress - 1

From the following particulars, compute the Annual value of the house.

- i) Municipal value Rs. 5,000
- ii) Rent received @ Rs. 600 p.m., Rs. 7,200.
- iii) Municipal tax Rs. 800.
- iv) Land revenue Rs. 300
- v) Interest on Loan taken for construction of the house in June, 1987 Rs. 400
- vi) Construction was completed on 1-4-1988.

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Check Your Progress - 2

From the following particulars of a self occupied house, calculate Income/Loss from it.

Municipal value	12,000
Municipal tax	1,000
Interest on loan taken for construction the house	800

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Check Your Progress - 3

List out the deductions allowed from the annual value.

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9.7 AMOUNT NOT DEDUCTIBLE

In unit number five we have mentioned that the income earned in India is taxable here in case of all types of assessee wherever it may have been received.

While discussing deduction under this head, we come across an item, namely, interest on borrowed funds. It may sometimes happen that the amount has been borrowed from a friend staying in the U.S.A. Whatever interest is paid to him arises in India and is therefore taxable here, whatever the residential status the lender may be. The interest so paid is, therefore, taxable here from the hands of the lender though he may have been staying outside India. In such a case it is the liability of the person paying interest to deduct income-tax at source and pay it to the government. Where the assessee fails to deduct income-tax at source and pay to the government, deduction of interest will not be allowed while computing taxable income from house property.

9.8 LOSS UNDER THE HEAD

Where the aggregate of all permissible deductions exceeds the annual value of any house property, naturally the income from house property will be a negative figure. In other words the head of income will yield loss. The loss so yielded will be set off against income from other head.

However, it may be noted that where the assessee owns only one residential house which could not actually be occupied by the owner because of the fact that owing to his employment, business or profession being carried on at any other place the annual value of such house will be taken to be nil and if this house yields any loss it will not be set off against any other income.

Note: W.e.f. the A.Y. 1993-94 the loss from the house property will not be allowed to be set off against the income under any other head of income. Further the carry forward of loss of any year from house property will be allowed to be set off only against income from house property of subsequent years. This does not hold good for self-occupied house property with NIL Annual Value. (Finance Act, 1992).

Check Your Progress - 4

Mr. X has three houses, one is self-occupied and two are let out. He has a loss of Rs. 1,000 from the self-occupied house. And his income from the let out house is Rs. 15,000. Compute his income from House Property.

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9.9 CO-OWNERSHIP AND DEEMED OWNER OF HOUSE PROPERTY

CO-OWNERSHIP :

Under section 26, where a house property is owned jointly and the share of the co-owners are definite and ascertainable, the share of each partner is assessed in him as part of his total income. Each co-owner's position is to be treated as a separate house.

Deemed Owner of House Property

In the following cases, the assessee, though not the owner of the house property, legally is deemed to be the owner u/s 27 of the Act.

1. An individual who transfers otherwise than for adequate consideration any house property to his / her spouse (otherwise than in an agreement to live apart), or to a minor child, not being a married daughter;
2. The holder of an impartible estate;
3. A member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or association;
4. A person who is allowed to take or retain possession of any building or part thereof in past performance of a contract of the nature referred to in Sec.53A of the Transfer of Property Act, 1882;
5. A person who acquires any rights in or with respect to any building or part thereof by virtue of any such transaction as in referred to in Sec.269 UA(f).

9.10 COMPUTATION OF INCOME FROM HOUSE PROPERTY

To summarise, the income from house property is to be computed as follows:

1. Property let on hire:

Annual value being the maximum of

- a) Municipal Valuation : b) Annual rent : and
 - b) Notional rent
- ...

	Less: Municipal taxes	...
	Annual Value	...
Less:	Deduction for newly constructed property let for residential purpose [Sec. 23(1)]	...
	Adjusted Annual Value	...
2.	Property occupied by owner : Annual value of a single house property in the occupation of the owner will be taken as Nil, provided it is neither let nor any other benefit is derived from it. Different treatment in case it is let during a part of year. (More than one such property to be treated as let on rent)	...
	Total Adjusted Annual Value	...
	Less: Deductions under Sec. 24 (1)	
1.	For property let on hire:	
	i) Repairs	...
	ii) Insurance	...
	iii) Annual revenue charge	...
	iv) Ground rent	...
	v) Interest on sums borrowed in respect of house property	...
	vi) Land Revenue	...
	vii) Vacancy allowance	...
	viii) Unrealised rent	...
2.	For property under the occupation of the owner, there is to be no deduction u/s 24 (1) except under (v) upto Rs. 5,000.	...
	Chargeable Income House Property	...

9.11 ILLUSTRATIONS

Problem - 1

Vaidyanathan is employed with Rayalseema Ltd. on a salary of Rs. 2,000 per month with dearness allowance of Rs. 5,000 per annum.

He is the owner of two houses. One is let out at Rs. 2,000 per month, whereas the other is occupied by him. Rental value of the second house is Rs. 500 per month. The houses are subject to local taxes at 20 percent of the rental value.

You are required to compute taxable income under the heads 'Salaries' and 'income from house property'.

Solution

Income from Salary:

Salary at Rs. 2,000 per month

24,000

Dearness allowance at Rs. 5,000 per annum

5,000

Gross Salary

29,000

Less: Standard deduction @ 33 1/3% of Gross Salary

9,667

Net salary

19,333

Income from House Property:

Let out house: Rental Value

24,000

(-) Local Taxes (20% of 24,000)

4,800

19,200

Self Occupied House :

Nil

Annual Value of two houses

19,200

Less Repairs - One sixth

3,200

16,000

Gross Income (total)

35,333

Problem - 2

Ghosh owns a house, the construction of which has completed on 1-4-1988. It has been let out for residential purposes to Chatterjee, a company director on a monthly rent of Rs. 3,000 per month. Other particulars in this regard are as follows:

	Rs.
Municipal Taxes	7,200
Ground Rent	1,000
Insurance	2,000
Interest on money borrowed for construction of the house	3,000
Collection charges actually paid	600

The house under reference had been mortgaged for Rs. 50,000 which had been spent on the marriage of his daughter.

Ghosh claims that he could not recover an amount of Rs. 4,000 from the tenant in spite of his best efforts to recover. The A.O. accepts the claim to treat the amount as unrealisable rent.

Compute taxable income from house property.

Solution

Annual Rent	36,000	
Less: Municipal taxes	<u>7,200</u>	
	28,800	
Deduction for new construction	<u>3,600</u>	
Annual Value		25,200
Less: permissible Deductions		
Repairs (one sixth of 25,200)	4,200	
Ground Rent	1,000	
Insurance	2,000	
Interest on borrowings used for construction	3,000	
Collection charges	600	
Unrealisable rent	<u>4,000</u>	<u>14,800</u>
Taxable Income		<u>10,400</u>

Problem - 3

Mr. Balaji took a land on lease and constructed one residential house property which has been completed on 1-4-1988. The same has been letout for an annual rent of Rs. 8,000. He furnished the

following particulars in respect of the house for the Assessment Year 1992-92.

	Rs.
Municipal Taxes	2,000
Ground Rent	100
Collection Charges	100
Interest on loan taken for construction	1,000
Unrealised rent of the last year	4,000
Fire Insurance	300

Compute his income from house property assuming that the Income-Tax Officer is satisfied regarding the admissibility of the irrecoverable rent.

Solution

	Rs.	
Rental Income	8,000	
Less: Municipal taxes	<u>2,000</u>	
	6,000	
Less: Deduction for new construction	<u>3,600</u>	
Annual Value		2,400

Permissible deductions:

Repairs (one sixth of AV)	400	
Ground rent	100	
Fire Insurance	300	
Collection charges	100	
Interest on loan	1,000	
Unrealised Rent	<u>500</u>	<u>2,400</u>
Taxable Income		<u>NIL</u>

Note: Unrealised rent can be deducted to the extent, income is available under the head. In

this case an amount of Rs. 500 can only be claimed out of the unrealised rent of Rs. 4,000 because with this allowance the income comes down to 'NIL'. The balance of Rs. 3,500 will be carried forward to the following year for claiming deduction.

Problem - 4

Mr. Bhushan owns a big house in Hyderabad which is let out to a firm at Rs. 8,000 per month. Local taxes amount to 10% which are shared equally by the landlord and the tenant firm. Mr. Bhushan has also to bear the following expenses in this regard:

	Rs.
Salary of gardener	5,000
Lighting	6,000
Water charges	3,000
Fire Insurance premium	2,000

In addition to the above, he claims the following amounts as deductions:

Repairs	30,000
Land revenue	5,000
Collection charges	3,000
Wealth tax	4,000

You are required to compute his taxable income.

Solution

	Rs.	Rs.
Rent received		96,000
Less: Local taxes payable by Bhushan	4,800	
Salary of gardener	5,000	
Lighting	6,000	
Water Charges	3,000	18,800
Annual Value		77,200
Less: Repairs: (one sixth of AV)	12,867	
Land revenue	5,000	

Fire Insurance premium	2,000
Collection charges	3,000
	<u>22,867</u>
Taxable income	<u>54,333</u>

Note: Wealth tax is not allowed to be deducted under this head.

9.12 SUMMING UP

The second head relates to 'Income from House Property' and you have been told that the taxability depends on ownership and on the annual value thereof. There are certain deductions and they have to be understood. Since interest on loan taken for construction purposes is an allowable expense, it is always preferable to borrow and then invest in construction. As there is a severe shortage of houses in the country, a special deduction is allowable in respect of new residential units if they are let out.

9.13 CHECK YOUR PROGRESS : MODEL ANSWERS

1. Computation of Annual Value:

	Rs.	Rs.
Municipal value	5,000	
Rent received @ Rs. 600 p.m. (w.e. is higher)	7,200	7,200
(-) Municipal taxes		<u>800</u>
	A.V.	6,400
(-) Construction Allowance		<u>3,600</u>
Net Annual Value		<u>2,800</u>

2. Municipal Value

	12,000
(-) M. Taxes	<u>1,000</u>
Net A.V.	11,000
Reduced to Nil u/s 23(2)	<u>11,000</u>
	Nil
(-) Interest on loan	<u>800</u>
Loss from the self occupied house	<u>(-) 800</u>

3. i) Repairs, ii) Insurance premium, iii) Annual charge, iv) Ground Rent, v) Interest on loan, vi) Land Revenue, vii) Collection charges, viii) Vacancy allowance, ix) Unrealised rent.

4. Income from let out house

15,000

(-) Loss from self occupied house

1,000

Income from House Property

14,000

9.14 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following in about 30 lines each:

1. Write a note on taxability of income from house property.
2. Explain the determination of the annual value of the house remaining vacant for the whole year.
3. Compute taxable income from house property in the following cases:
 - (a) Amitabh is employed as a Senior Officer with Arun Ltd. on a salary of Rs 5,000 per month plus dearness allowance of Rs. 1,000 p.m. He owns a house which is used for his own residence and whose municipal value is Rs. 80,000 in respect of which he has to pay local taxes at the rate of 10 percent.
 - (b) Shyam owns a big building which contains five residential units with the annual value of Rs. 2,400, 3,600, 4,000, 5,000 and 6,000 respectively. Municipal taxes at the rate of 10 percent is payable thereon. These units were ready after construction in April, 1988.
4. Compute gross total income of Mr. Jitendra whose particulars of income are as follows:

Salary: Rs. 4,000 per month, dearness allowance of Rs. 500 per month, rent free house of the rental value of Rs. 10,000 per annum. He earns rent of Rs. 20,000 per annum in respect of which he has to pay local taxes of Rs. 4,000 per annum. He had borrowed a loan of Rs. 1,00,000 in respect of which he pays interest at 15 percent.

II. Short Questions

Answer the following in about 15 lines each:

1. Explain exempted incomes from house property.
2. Indicate with illustration how annual value is determined.
3. How is annual value determined in respect of newly constructed residential house?
4. Describe the deductions allowed out of annual value. Give illustrations.
5. How do you compute the annual value for a house that remained vacant for a part of the year?
6. Explain the following terms:
 - i) Annual value
 - ii) Unrealised Rent.

UNIT - 10: PROFITS AND GAINS OF BUSINESS OR PROFESSION-I (SEC. 28 TO 44)

Contents

- 10.0 Aims and Objectives
- 10.1 Introduction
- 10.2 Terms Defined
- 10.3 Charging Provision
- 10.4 Admissible Deductions
- 10.5 Expressly Allowed Deductions
- 10.6 General Deductions
- 10.7 Restricted Admissibility
- 10.8 Expressly Disallowed Expenses
- 10.9 Illustrations
- 10.10 Summing Up
- 10.11 Check Your Progress: Model Answers
- 10.12 Model Examination Questions

10.0 AIMS AND OBJECTIVES

The objective of this unit is to explain you the expenses which are allowed as well as not allowed for deduction while computing taxable profits of business or profession.

At the end of the unit, you should be able to :

- identify the incomes chargeable under the head 'Profits and Gains of Business or Profession',
- explain the admissible deductions,
- list out expressly allowed and disallowed expenses,
- explain the items of restricted admissibility.

10.1 INTRODUCTION

'Profits and gains of business or profession' the third head on income, is important for many reasons which we will discuss in the next few pages. The students will learn the computation of taxable profits under this head. In other words, they would be prepared to deal with the computation

of income in case of any businessman and a professional.

You are familiar with the computation of income by preparing Profit and Loss Account in Accountancy. You have learnt that all expenses incurred during the year are debited to P & L Account and all incomes received or accrued are shown on the credit side. After taking into account the closing stock, depreciation, accruals and some of the items which might not have been incorporated in the P & L Account, we compute net profit which is then either sent to the balance sheet or appropriated by way of dividend provision, tax provision and transfer to general reserve etc. You have also been told that the owners of the firm have to decide about the depreciation policy, etc. How much depreciation has to be written off and what method of depreciation (straight line, diminishing balance method, sinking fund and so on) has to be followed, all depend on the decision of the owners. There is no law governing all these issues. Thus in a given situation, various types of owners will arrive at different figures of profit depending on the quantum of debits. The debits on the profit and loss account can be managed. To illustrate, Company 'A' has got a publicity film prepared at a cost of 5,00,000. If this amount is treated as expense, the profit of the year will be less by Rs. 5,00,000, but if on the other hand, this amount is treated as an asset, the profit of the year will not be affected by the cost incurred on getting the film prepared.

We may therefore, conclude that if the government has to tax business profits, it must lay down the rules of treatment of expenditure and depreciation etc., so that all the assesseees are enabled to follow the rules uniformly and arrived at the taxable profits correctly. It is therefore, necessary that the Income Tax Act prescribes which expenses are to be allowed to be debited on the debit side of the profit and loss account and which expenses should not be allowed to be debited. The Act has given a list of all those expenses which are allowed and all those which are not allowed. However, since it is not possible to prepare a comprehensive list of all expenses it is stated that the expenses incurred in the course of business, and for business expediency, are permitted. Since the subject matter under this topic is sizable, it is proposed to devote two units in respect of this head. In this unit we will concentrate our attention on the items which are allowed, and on those which are not allowed.

10.2 TERMS DEFINED

Business

The term 'Business' has been defined in Section 2 (13) of the Act. It includes "any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce or manufacture".

The definition stated above, is very wide in nature. It will cover almost everything which resembles business. It is something which occupies attention and labour of a person for the purpose of profit. The word business means almost anything which is an occupation or duty requiring attention as distinguished from sports or pleasure and is used in the sense of occupation continuously carried on for the purpose of profit.

Profession

The word 'Profession' is of still wider scope than 'business'. What may not amount to business may amount to 'profession' and what may not amount to 'profession' may amount to 'vocation' and

what may not amount to 'vocation' may amount to occupation. A profession in the present use of language involves the idea of an occupation requiring either purely intellectual skill, or if any manual skill, as in painting and sculpture or surgery, skill controlled by the intellectual skill of the operator, as distinguished from an occupation which is substantially the production, or sale, or arrangements for the production or sale of commodities.

Vocation

The word 'vocation' is in common use, and is defined as meaning an occupation or trade, one's regular calling or business, a calling or occupation or business in which one engages more or less regularly: the activity upon which a person spends the major portion of his time and out of which he makes his living, that too which one is called by some special fitness or sense of duty, i.e., usual avocation. It has been said that this conveys the idea of systematic employment which implies continuous or habitual course of dealings.

Occupation

The word 'occupation' is employed as referring that which occupies time and attention, it also means a calling or a trade. The term 'occupation' expresses the idea of continuity, a continuous series of transactions and implies regularity.

Adventure in the nature of Trade

Profit from an isolated transaction will also be taxable as business profit if it is in the nature of trade. The transaction may not constitute trade or business but, if it is allied to business or trade, profit there-from will be taxable under the head business.

To illustrate, Rahim buys two bags of wheat every year for consumption by the family. In a particular year he feels that the price of wheat will rise and therefore he decided to buy 100 bags of wheat only to sell at a future date when the price move up. He does it and makes a profit of Rs. 5,000.

The sale and purchase by Rahim in this case does not constitute business or trade because there is only one transaction and an isolated transaction will not amount to business or trade. However, the transaction resembles business. He brought wheat with a view to selling and it is therefore, in the nature of trade. Profit earned thereon is taxable under the head 'business'.

Deciding Factors

In deciding the character of such transactions the following factors are relevant:

- (i) Whether the purchaser is a trader and the purchase of the commodity and its resale are allied to his usual trade or business or are incidental thereto?
- (ii) The nature of the commodity purchased and resold and in what quantity was it purchased and resold?
- (iii) Whether the purchaser by any act subsequent to the purchase has improved the quality of the commodity purchased and thereby made it more readily saleable?

- (iv) What were the incidents associated with the purchase and resale?
- (v) Were they similar to the operations usually associated with the purchase and resale?
- (vi) Are the transactions of purchase and resale repeated?
- (vii) Does the element of pride of possession come into the picture in regard to the purchase of the commodity and its subsequent possession by the purchaser?
- (viii) Was the purchase made with the intention to resell at a profit?

10.3 CHARGING PROVISION [Section (28)]

According to Section 28 of the Act following incomes are chargeable to tax under the head 'Profits and Gains of Business or Profession.'

1. Profits from Business [Sec 28 (i)]

The profits and gains of any business or profession which was carried on by the assessee at any time during the previous year are taxable under this head. You will notice the following two points here:

(a) The business must have been run, may be for any duration during the previous year.

(b) It must have been run by the assessee.

2. Compensation [Sec. 28 (ii)]

Compensation received in the course of business is also taxed as business profit. Following types of compensation have been mentioned in the section:

(a) Compensation will be received by any person managing an Indian Company or any other company in India for termination of his management contract. Any compensation payable for modifying the contract is also taxable.

(b) Compensation will be received for termination of an agency contract or for modifying such contract is taxable.

(c) Compensation will be received for vesting in the government or any government company the management of any property or business in India.

To illustrate, Chatterjee holds a selling agency for Hindustan Lever products and is allowed commission at the rate of 10%. The Company desires to reduce the commission from 10 per cent of 8 per cent and agrees to pay a compensation of Rs. 1,40,000 for such modification in the agency contract. The compensation so receivable by Chatterjee is taxable as business profits.

3. Income of a trade Association [Sec. 28(iii)]

You might be aware of so many associations formed by various business groups. For example,

Hyderabad Hoteliers Associations, Abid Cloth Merchants Association, Chamber of Commerce, Indian Merchants Chamber and so on. They derive some of their income by way of subscriptions which they spend on the welfare activities relating to their members. It is possible that some of the subscription amount remains unspent. This unspent amount is not taxable as it does not come from outside and based on the principle of mutuality.

However, it is just possible that the association might be rendering some specific service to its members against the payment of some nominal fees. The amount received for such services is treated as taxable business profit. For example, the Chamber of Commerce is making available certain information as demanded by its members against payment of fees. The fees so collected is taxable under this head..

4. Profit on Sale of Licence [Sec.28(iii a)]

Profit on sale of licence granted under the Imports (Control) Order, 1955, is taxable under this head.

5. Cash Assistance [Sec.28 (iii b)]

Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India.

6. Refund of Duty [Sec.28(iii c)]

Any duty of customs or excise repaid or repayable as draw back to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971, is taxable under this head.

7. Benefit arising from business [Sec.28(iv)]

The value of any benefit or perquisite arising from business or the exercise of a profession is taxable under this head.

8. Amounts due to or received by a partner from his firm [Sec.28(v)]

Amounts due to or received by a partner from his firm by way of interest, salary, bonus, commission or remuneration is taxable to the extent it is allowed to be deducted under section 40(b) under this head w.e.f. the A.Y 1993-94.

9. Speculation

Speculation is considered as a separate business. Any income from speculation is taxable under this head but that income has to be treated separately and should not be mixed-up with ordinary business profits.

Speculation has been defined as "a transaction in which a contract for the purchase or sale of any commodity including stock and shares is settled otherwise, than by the actual delivery or transfer of the commodity or scrip". For example Abbas enters into a contract to buy 500 bags of sugar from Nair at a price of Rs. 500 after two months. On the date of delivery the ruling price of sugar is 550. Nair will not be required to arrange for the delivery of 500 bags but will discharge his

contractual obligation by paying Abbas Rs.25,000 being the difference between the ruling price and the contracted price. Since the actual delivery of sugar has not taken place in this transaction, it falls in the category of speculation.

10.4 ADMISSIBLE DEDUCTIONS

We have stated elsewhere that the taxable income will depend on the quantum of admissible deductions. Though the Act has prescribed certain deductions under the law, you will appreciate that it is not possible to prepare an exhaustive list of all business expenses and say that except these expenses no other expenditure will be permissible. It is therefore, left open to claim deductions for various business expenses incurred during the course of business. While allowing these expenses as allowable, one has to see that they have been incurred for the business. We have also to see the accounting principles and other judicial pronouncements as regards admissibility or other wise of these accounts. Certain principles have emerged out of the court decisions and a few of them are given below:

i) Existing Liability

Only those accounts will be allowed to be deducted for which the liability exists at the time of preparation of final accounts. No deduction is allowed towards a future liability or any liability that is likely to arise in future.

ii) For the Business

The amount must have been incurred for the business. It is not necessary that the expenditure must have been incurred for making profits. It is right, if it is incurred during the course of business and it was necessary from the point of view of commercial expediency. For example, amount spent in arranging a farewell function for a district official may not be business proposition immediately, but the amount may be necessary from the point of view of commercial expediency because the business might be needing the help of all such officials during the course of business or for smooth running of business.

iii) Losses Incidental to Business

Losses incidental to business have to be allowed as business expenses while computing taxable business profits. There is a difference between loss and expenses. Expenses are incurred and the money moves out of your pocket knowingly, and it is controllable to some extent. However, loss comes to your efforts to prevent it.

iv) Onus

When the assessee claims an expenditure as deductible, it is for him to prove that the particular expense is deductible, having been incurred for the business and is thus an admissible deduction. The burden of proving is, therefore, on him.

v) Single Transaction

We have stated earlier that profits from a single transaction are also taxable if that is in the nature for trade. In case of single transaction all expenses have to be deducted out of the receipts.

and it is immaterial whether the amount has been incurred in one accounting year or the other. The profit in respect of single transaction is found out by deducting all expenses relating thereto from the income therefrom.

Check Your Progress - 1

Whether the following items are deductible in the computation of income under the head "Profits and Gains of Business or Profession".

- i) Cash payment supported by a proper voucher to an advertisement agent Rs. 15,000.
- ii) Interest paid to a non-resident outside India, without deduction of tax at source.
- iii) Provision for bad debts.
- iv) Reasonable salary paid to a partner.
- v) Interest paid in respect of moneys borrowed for agricultural purposes.
- vi) Penalty paid to customs authorities for infringement of Import Control Regulations.
- vii) Rent paid by a firm to one of its partners for his house occupied by the firm.

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Check Your Progress - 2

Decide whether the following items are allowed or not allowed for deduction.

- i) Loss by theft from shop during working hours.
- ii) Expenditure on special advertising campaign.
- iii) Legal charges on patent rights.
- iv) Expenditure on diaries and calendars.
- v) Sales tax due but not paid.
- vi) Compensation paid for destruction of hired machinery.
- vii) Compensation paid to a retrenched employee.

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10.5 EXPRESSLY ALLOWED DEDUCTIONS

Though the expenses are allowed in general, provided they are related to business and have been incurred in running of the business, there are certain items which have been specified in the Act to be allowed while computing taxable business profits. They are stated below:

i) Rent, Rates, Taxes, Repairs and Insurance for Building (Sec.30)

Where the building in which the business is carried on is owned by the assessee, various expenses incurred on the building by way of taxes, repairs and insurance are allowed. On the other hand if the building is obtained on hire, rent is allowed. In respect of the hired building, if the assessee is required to take care of the repairs, insurance or taxes, they will also be allowed.

ii) Repairs and Insurance of Plant, Machinery and Furniture (Sec.31)

In respect of machinery, plant and furniture, any amount incurred on repairs, insurance etc., is an admissible deduction.

iii) Depreciation (Sec.32)

We have already made it clear that depreciation of the assets owned by the assessee is a necessary business expense. It has, therefore, to be allowed. You must be aware that it is necessary, to claim depreciation only when you own it. On the other hand, if the assets have been obtained on hire, you will claim only the hire charges and not the depreciation. It will then be claimed by the person who owns these assets and who has lent them to you on hire. Particulars regarding depreciation will be explained in lesson Number 12.

iv) Expenditure on Scientific Research (Sec.35)

You will have noticed that generally all industrial houses have to spend a lot of money on research and development (R&D), which keeps them upto date as regards latest technology. It is therefore necessary for the government to allow all such expenses to be deducted while computing taxable profits. Various provisions in this regard are as follows:

- (i) Revenue expenses on scientific research pertaining to business are allowed in full.
- (ii) Sums paid to scientific association, university, college or other associations to be used for scientific research is allowed.
- (iii) Any sum paid to a university, college or other association to be used for social or statistical research is allowed. However, it is necessary that such institutions are approved by the prescribed authority.
- (iv) Capital expenditure on scientific research relating to the business of the assessee, is also allowed in full.

- (v) It is to be understood that any amount incurred on buying of land after 29th February, 1984, is not allowed.
- (vi) Amount incurred during three years preceding the commencement of business by way of salary to research personnel shall be allowed as deduction in the year in which the business is commenced.
- (vii) Sometimes it may become necessary that any asset having been used for scientific research first may have to be used for other purposes in business. In such cases, if the entire cost of the asset has been allowed earlier, then this asset will not be eligible for depreciation because its written down value is already zero.

v) Expenditure on Acquisition of Patent rights (Sec-35 A)

Patent rights have a life span of 14 years. Therefore any amount spent on acquiring such rights has to be written off over a period of 14 years. Where the used rights have been bought, then the price paid thereof will be deductible over the number of years which will be available for the assessee for exploitation.

vi) Expenditure on known-how (Section 35 AB)

Where any assessee has paid any lumpsum consideration for acquiring any know-how for use for the purpose of his business, he will be allowed deduction for the same in six equal annual instalment beginning from the previous year in which the know-how had been acquired. On the other hand, if this know-how is developed in a laboratory/university/institution referred to in Section 32A (2B), the consideration shall be allowed as deduction in three equal annual instalments.

vii) Expenditure on Eligible Projects or Schemes (Sec.35AC)

Deduction will be allowed in respect of the expenditure incurred for an eligible project or scheme for promoting social and economic welfare of the public on the recommendations of the national committee constituted by the Central Government. This is w.e.f. the A.Y. 1993-94.

viii) Payments to Associations or Institutions for carrying out Rural Development Programmes (Section 35 CCA)

Where any assessee pays any amount to (a) an association or institution engaged in any programme of rural development or (b) an association or institution which undertakes training of persons for implementing any programmes of rural development or (c) a rural development fund set up and notified in this behalf by the Central Government, he will be allowed a deduction of the whole of such expenditure. However, the programmes of rural development should have the approval by the prescribed authority before 1st March 1983.

ix) Expenditure by way of payment to an Association or Institution for carrying out any Approved Programmes of Conservation of Natural Resources (Sec- 35 CCB)

Any payment made to an association or institution which has its object as the undertaking of programmes of conservation of natural resources to be used for carrying out any such programme is allowed under Section 35CCB. The only condition is that the contribution receiving organisation

should have been approved by the prescribed authority.

x) Amortisation of Certain Preliminary Expenses (Sec-35 D)

Preliminary expenses incurred by an Indian company or a resident assessee will be allowed to be deducted over a period of ten years. It is known as amortisation. To summarise, all expenses in respect of the following and incurred before the commencement of business, are first shown as an asset and then one-tenth thereof is allowed to be written off every year. The following expenses qualify for amortisation under the section 35D:

- (i) Legal charges for drafting the Memorandum and Articles of Association.
- (ii) Printing of the Memorandum and Articles of Association.
- (iii) Registration fees of the Company.
- (iv) Underwriting commission, brokerage, drafting charges, typing, printing etc., of the prospectus relating to issue of shares, and
- (v) Any other item of expenditure as prescribed.

xi) Expenditure on Prospecting or the Development of Specified Minerals (Sec-35E)

Under section 35E the benefit of amortisation is given to an Indian company or to a resident non-corporate assessee. The time over which the amount is to be written off is ten years. The expenditure incurred qualifies for deduction when it relates to any operation pertaining to prospecting for, or extraction or production of any mineral. The expenditure that qualifies for amortisation must be incurred during that year of commercial production and the four previous years. The minerals for the prospecting or development for which expenditure may be incurred are mentioned in the Seventh Schedule of the Act.

xii) Other Deduction (Sec-36)

Following are the other deductions that are allowed under Section 36.

- (i) *Insurance Premium:* The amount of any premium paid in respect of insurance against risk of damage or destruction of stock or stores used for the purpose of the business or profession.
- (ii) *Premium on the Lives of Cattle:* Premium paid by a federal milk co-operative society to effect or to keep in force an insurance on the life of cattle owned by member of a co-operative society. It must be a primary society engaged in supplying milk raised by its members to such federal milk co-operative societies.
- (iii) *Premium for Employees' Health insurance:* Where the assessee, being an employer, pays (a) the amount of any premium (b) to effect or keep in force an insurance (c) on the health of his employees (d) under a scheme framed by the Central Government, the said amount will be allowed as deduction, provided, (e) it is paid by a cheque.

- (iv) **Bonus or Commission to Employees :** A sum paid to an employee as bonus or commission for service rendered.

It is important to learn that the deduction in respect of bonus paid to an employee employed in a factory or other establishment to which the provision of the Payment of Bonus Act apply shall not exceed the amount of bonus payable under that Act.

- (v) **Interest on Borrowed Capital:** The amount of interest paid in respect of capital borrowed for the purpose of business or profession.
- (vi) **Employer's contribution to Recognised Provident Fund and Approved Superannuation Fund.**
- (vii) **Employer's contribution to Approved Gratuity Fund.**
- (viii) **Write off Allowance for Animals:** In respect of animals for purposes of business, there is no provision of any depreciation being allowed in respect thereof. However, on the death of an animal, the full amount is allowed to be written off in computing taxable profits.
- (ix) **Bad Debts :** Bad Debts are quite natural for any business house. The Act also therefore permits the deduction of bad debts in computing taxable profits. However, it is necessary to comply with the conditions given hereunder, before claiming deduction under this item.

Conditions Governing Allowance of Bad Debts

- (a) Deduction on account of bad debts shall be allowed only when it has been written off as irrecoverable in the accounts of the assessee for that previous year.
- (b) Bad debts may also be allowed if they had been written off in an earlier previous year but not allowed by the A.O. on the ground that they had not been established to have become bad debt in that year.
- (c) Where the assessee has written off some debts in the previous year which in the opinion of the A.O. became bad in any earlier previous year, he will reopen the assessment of that year and recompute the income of that year after allowing such bad debts.
- (d) The A.O. may allow a part of the debts as bad, instead of allowing full amount.
- (e) Where a deduction is allowed in respect of bad debts and any amount is recovered subsequently, then such recovery shall be put to tax in the year of recovery.
- (f) Deduction is allowed only when such debt has been taken into account in computing the income of the assessee or represents money lent in the ordinary course of business of banking or money lending.
- (x) **Provision of Bad and Doubtful Debts by Banks:** A deduction can be provided in respect

of provision for bad and doubtful debts made by all banks upto 5 percent of their total income and an additional 2 percent of the aggregate average advances made by rural branches of banks.

Rural branch means a branch of a scheduled bank or a non-scheduled bank situated in a place which has a population of not more than 10,000.

All bad debts occurring should be met out of such reserves. Where bad debts exceed the quantum of reserves available at a point of time, the excess only shall be allowed as deduction by way of bad debt.

10.6 GENERAL DEDUCTIONS (SECTION 37)

This section is a residuary section. Deductions not covered under the specific admissibility provisions described above will be permissible here under Section 37, provided the expenditure has been incurred for the business.

Any expenditure laid out or expended wholly and exclusively for the purposes of business or profession shall be allowed in computing the income chargeable under the head "Profits and Gains of Business or Profession". In deciding the deductibility under this residuary head we must see that expenses belong to a category not covered by the categories named earlier from 30 to 36, and it must not be an expenditure of capital nature. The expenditure must be incurred wholly and exclusively for business and during the previous year. It is incidental to business and springs directly from it.

Examples of Allowable Expenses

1. Expenditure incurred in connection with the procurement of raw materials for manufacturing business.
2. Payment made by a motor vehicle dealer for imparting training to his apprentice.
3. Expenses on purchase by a hotel on crockery and linen for replacement.
4. Amount spent for securing the use of a trade mark which would help in the foreign trade of the assessee.
5. Annual payment made in terms of a 99 year lease of the entire undertaking.
6. Brokerage and stamp duty incurred for taking a five year lease of office premises.
7. Expenses incurred by the lessor in granting the lease of its business assets.
8. Expenditure incurred in digging trenches to prevent fire from adjacent seam spreading to assessee's coal seam.
9. Expenditure incurred for maintaining existing tenancy rights.
10. Annual payment made to a retiring director was held allowable on the ground of commercial expediency.

11. Payment of share of profits to a retiring partner.
12. Amount spent for making huts and camp expenses for labour.
13. Additional price for sugarcane purchased from co-operative society payable under the relevant control Act.
14. Stamp duty, registration fees etc., of the deed of retirement or partnership.
15. Deficit in obsolete machinery on physical verification.

Examples of Expenditure not Allowed

1. Payment made for purchasing interest of the other partner in the firm.
2. Payment made under an agreement for assuming control over a canteen which was joint property of the assessee and the payee.
3. Payment made for acquiring competing business for a term of nine years.
4. Legal expenses incurred in connection with acquisition of investment of shares.
5. Stamp duties, registration charges, solicitor's fee etc., for execution of a five-year lease deed for taking a new factory.
6. Payment in the shape of royalty agreed to be paid by the assessee purchaser to the vendor of sole selling agency for liquor at a certain rate per case of liquor sold by the assessee.
7. Interest paid to legalise assessee's right of occupation.
8. Payment made by lessee to lessor to prevent the latter from granting similar lease rights in neighbouring quarries.

Check your progress-3

List out the expressly allowed expenses.

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10.7 RESTRICTED ADMISSIBILITY

You have been told about the deductibility of expenses which have been expressly allowed and the expenses which are allowable under the residuary section 37. There are certain expenses which are allowed, but the government is of the opinion that such expenses while allowing should be under some restraint. In other words, the Act, while permitting deduction of these expenses,

must put some limitation thereon. We will study such restrictions here.

i) Entertainment Expenses

You might have seen businessmen entertaining their customers and clients with tea, tiffin, lunch and dinner, etc. Such expenses are incurred for the sake of business and in business expediency they are allowed. But they are allowed within limits as stated below:

- | | | |
|-----|---|--|
| (a) | On the first Rs.10,00,000 of profits (computed before making any allowance for development rebate, development allowance or an investment allowance.) | 1/2% of such profits or Rs.5,000, whichever is higher. |
| (b) | On the next Rs.40,00,000 of such profits and gains. | 1/4% of such profits. |
| (c) | On the balance of such profit or gain | 1/8% of such profits. |

The maximum deduction in respect of entertainment expenditure is limited to Rs.50,000.

Note: W.e.f. the A.Y 1993-94, deduction on account of entertainment expenditure shall be limited to the amount of Rs.10,000 plus 50 percent of the amount exceeding Rs.10,000 (Finance Act, 1992).

Explanation

The term 'entertainment' expenditure includes expenditure on hospitality of every kind whether provided under any express or implied contract or custom or usage trade. It does not include expenditure on food or beverages provided to the employees in their place of work.

ii) Advertisement in any Souvenir of Political Party

No deduction shall be allowed in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract pamphlet or the like published by a political party. It is relevant to note that the term, political party, has not been defined for the purpose of these provisions. As such the term will bear its ordinary meaning.

iii) Advertisement and Guest House Expenses

Any expenditure incurred on advertisement or on any residential accommodation, including a guest house or on travelling shall be allowed within the limits, prescribed by Income-Tax Rules. The relevant rules are 6B and 6D which are summarised below:

(iiiA) Advertisement [Rule (6B)]

- (i) Articles intended for presentation upto a limit of Rs.200/- per piece
- (ii) Expenditure in foreign exchange for publicity outside India to remain restricted upto the amount of foreign exchange allowed.

(iii) The A.O. will have the power to disallow that part of the expenditure on advertisement which in his opinion is excessive or unreasonable, having regard to the legitimate needs of the tax payer and the benefit derived therefrom. Such disallowance can however, be made in the following cases only:

- (a) Where the payment is made to a person who has a substantial interest in the business of tax payer or to the relative of such person.
- (b) Where the payment is made to a person who carries on business or profession as a publicity or advertisement agent and the tax payer has a substantial interest in that business or profession.
- (iv) Any expenditure on advertisement for which payment has been made in a sum exceeding Rs.10,000/- shall not be allowed as a deduction while computing the total income unless such payment is made by a crossed cheque or a crossed bank draft.

Note: The Ceiling limit in respect of each article increased from Rs.200 to Rs.1,000 plus 50 percent of the amount in excess of Rs.1,000 w.e.f. the A.Y. 1993-94.

(iii B) Travelling [Rule 6D)]

The allowance in respect of expenditure on travelling is also restricted. The expenses allowed in respect of foreign travelling shall be restricted to a proportion of the aggregate amount of foreign exchange granted or permitted to the assessee for such a travel and the amount expended on such travel in terms of rupees.

Expenditure on travel within India but outside the headquarters shall be limited to the following amounts:

- a) In respect of travel by rail, road, water ways or air the expenditure actually incurred.
- b) In respect of any other expenditure including hotel expenditure or allowance paid in this connection:
 - (i) In the case of an employee whose salary is Rs.1,000 p.m. or more Rs.150 per day or part thereof.
 - (ii) In respect of any other employee Rs. 75 per day or part thereof.
 - (iii) In respect of any other person An amount calculated at the rates applicable in the cases of the highest paid employee of the assessee.

If the stay of such employee or other person outside his head quarters is at Bombay, Calcutta or Delhi, the amount computed at the above rates shall be increased by 33.33% of such amount.

In case where the employee or such other person stays outside the headquarters free of charge in a guest house maintained by the assessee, the admissible amount will be restricted to one-third

of the above rates. On the other hand, if the employee is provided with free lodging only, the admissible amount will be restricted to 50% of the above limits.

Note: The amount of deduction in respect of the above item has been fixed at Rs.1,500 plus 75 per cent of the amount in excess of Rs.1,500 per day w.e.f. the A.Y. 1993-94.

10.8 EXPRESSLY DISALLOWED EXPENSES (Sec.40)

Out of the expenses incurred by the assessee in business, we may disallow all such expenses being in the nature of capital expenses. Under the Income-Tax Act also, certain expenses have been specified as disallowed and they are known as expressly disallowed expenses.

i) In the case of Any Assessee [Sec.40 (a)]

(iA) Interest payable outside India

Any Interest chargeable under the Act and which is payable outside India will not be allowed if income tax at source has not been deducted while paying the amount. In case the payee has some person in India who can be treated as his agent for payment of tax on his behalf, then disallowance will not work.

(iB) Any other Tax

Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession are assessed at a proportion of or otherwise on the basis of any such profits or gains.

(iC) Wealth tax liability in respect of business assets.

(iD) Salary payable outside India.

Any payment which is chargeable under the head 'Salaries' if it is payable outside India and if the tax has not been paid thereon nor deducted therefrom.

(iE) Payment to Provident Fund.

Any payment to a Provident or other fund established for the benefit of employees of the assessee. It will be disallowed, if the assessee has not made effective arrangements to ensure that tax shall be deducted at source, while the payment is made from such fund if that is chargeable to tax.

(ii) In the case of firm [40 (b)]

In the case of a firm, the payment of interest, salary, bonus, commission or any other remuneration made by the firm to any partner of the firm is disallowed. But rent paid to a partner in respect of the business premises owned by him is allowed.

Note: W.e.f. the A.Y. 1993-94 the following charges will come into force:

- a) In respect of interest paid to partners, it will be allowed as a deduction subject to the maximum of 18 per cent simple interest.

- b) In respect of salary, bonus, commission or remuneration, paid to partners, it will be allowed as a deduction subject to certain limits.

10.9 ILLUSTRATIONS

I) Discuss the admissibility or otherwise of the following expenses of businessman

- a) The assessee company paid to the association representing the manufactures of its line, and its share of expenses for propaganda to counter the move of compulsory colourisation of Vanaspati.
- b) Rs.300 paid by a firm to a lawyer for drafting its deeds of partnership when it commenced its business and Rs.1,000 spent in publicity during the two months before it started business.
- c) The assessee in order to obtain a lease of a new building paid a sum of Rs.1,001/- to the landlord as an extra payment over and above the stipulated rent; and claimed deduction of the same as a revenue expenditure. The claim was disallowed by the departmental authorities.

ANSWER:

- (a) The amount was paid out by the assessee wholly and exclusively for the purposes of its business and was an allowable deduction in the computation of profits.
- (b) The amount of Rs.300 paid for drafting the partnership deed is covered by Sec.35D for amortisation over a period of 14 years but Rs.1,000 spent on the publicity is not admissible deduction. Initial expenditure is regarded as a capital amount since it is incurred not for earning profits but for putting the profit earning apparatus into action.
- (c) The expenditure not having been incurred for the purposes or bringing into existence any asset or advantage of an enduring character, and the payment not having been made in order to secure the lease for any term of years but only for purpose of continuous running of the business, though in a new premises, the sum of Rs.1,001 is deductible in arriving at the assessee's income.

II. How would you treat the following:

- a) Lifting of cash box by a stranger during office hours.
- b) Expenses incurred in defending itself in a winding up petition filed by a shareholder.
- c) Pledged ornaments stolen from the bank and amount paid by the bank to its customers for the loss by theft.
- d) Lumpsum received in lieu of yearly payment of royalty.
- e) Amount advanced to sugarcane growers by sugar mill had to be written off due to drought conditions.

ANSWER

- (a) This is not trading loss being not incidental to business. It is immaterial that the theft took place during office hours.
- (b) Expenditure incurred by the company to sustain and maintain its existence should be treated as revenue expense and is therefore, allowable.
- (c) Though the bank was not obliged to make good the loss due to theft being a bailee, yet the payment is made to save the reputation and good will of the bank. The expenditure was incurred wholly and exclusively for the business and so is allowed.
- (d) Lumpsum received in lieu of annual payment of royalty is a revenue receipt and therefore taxable like any other trading receipt.
- (e) The loss to the sugar mill on account of non-recovery of advances to the sugarcane growers is of revenue and so allowable. It is incidental to business to give advance to cane growers.

10.10 SUMMING UP

Certain deductions are expressly allowed while computing profits and gains from business. They are, rents, rates, taxes, repairs, depreciation, development allowance, expenditure on scientific research, expenditure on acquisition of patent rights, etc. There are also some expenses which are permitted limitedly, like entertainment expenses, advertisement, guest house expenses, etc. And certain expenses are expressly disallowed for deduction. They are interest, salary payable outside India, payment to provident fund, etc.

10.11 CHECK YOUR PROGRESS: MODEL ANSWERS

- 1. i) Any payment exceeding Rs.10,000 should be made through a crossed cheque or draft until and unless it is exceptional case. It is disallowed.
- ii) This payment is disallowed.
- iii) Not allowed
- iv) Not deductible
- v) Not allowed.
- vi) Not deductible as it is paid for violation of Law.
- vii) Allowed
- 2. i) Revenue loss, hence allowed.
- ii) Allowed.

- iii) revenue expense, hence allowed.
- iv) Allowed.
- v) Not deductible.
- vi) Allowed.
- vii) Allowable deduction.
- i) Rent, rates, taxes, repairs for building.
- ii) Repairs and insurance of plant and machinery,
- iii) Depreciation,
- iv) Development allowance,
- v) Expenditure on Scientific Research,
- vi) Expenditure on acquisition of Patent Rights,
- vii) Amortisation of certain preliminary expenses,
- viii) Other deductions, U/S 36, etc.

10.12 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following in about 30 lines each :

1. Explain and illustrate the various items chargeable under the head profits and gains of business or profession.
2. State the principles which will govern the allowability of expenses under the head business or profession?
3. Enumerate the various deductions allowable under section 36?
4. Give five examples which are not allowable under Section 37 and ten examples of which are allowed?

II. Short Questions

Answer the following in about 15 lines each :

1. Explain and illustrate the term 'adventure' in the nature of trade?

2. What are expressly allowed deductions?
3. How do you treat expenditure on scientific research?
4. What are the conditions governing the admissibility of bad debts?
5. Give five examples of expenses not allowed?
6. Explain the expressly disallowed expenses?

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UNIT - 11 : PROFITS AND GAINS OF BUSINESS OR PROFESSION-II

Contents

- 11.0 Aims and Objectives
- 11.1 Introduction
- 11.2 Expenses not Deductible under certain Circumstances
- 11.3 Deemed incomes
- 11.4 Profits Chargeable to Tax
- 11.5 Valuation of Stock
- 11.6 Method of Accounting
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- 11.8 Important Circulars Issued by the Board
- 11.9 Computation of Profit/Loss from Business or Profession
- 11.10 Illustrations
- 11.11 Summing Up
- 11.12 Check Your Progress : Model Answers
- 11.13 Model Examination Questions

11.0 AIMS AND OBJECTIVES

In continuation to the various provisions regarding computation of taxable profits, explained in the previous unit, the main objective of this unit is to explain you the other expenses which are not allowed under certain circumstances. We will also discuss deemed incomes and other topics which make the discussion full.

After reading the unit, you should be able to :

- describe the expenses which are not deductible under certain circumstances,
- explain the deemed incomes,
- appreciate the allowance or disallowance of any particular expense,
- compute Profits and Gains from Business or Profession

11.1 INTRODUCTION

In the earlier unit we have explained that in order to compute the taxable profits of a business or profession, it is necessary to learn the provisions regarding admissibility and non-admissibility of various items. We have also explained that generally all those expenses are allowed which are necessary for the running of business. However, the Act has named certain expenses which are allowed under the Act. These are known as expressly allowed deductions. On the other hand we are aware that all those expenses which are not at all concerned with business or which are capital in nature are not allowed. The Act has in this regard also named certain items which are not to be allowed while computing taxable profits. These are known as Expressly Disallowed Expenses. There are also expenses which, though admissible, have certain restrictions attached to them. All such provisions have been given earlier. We continue discussion of computation of business profits under certain other head. It is expected of you to recollect here what you had earlier done in the unit dealing with capital and revenue.

11.2 EXPENSES NOT DEDUCTIBLE UNDER CERTAIN CIRCUMSTANCES

i) Unreasonable Expenses [Sec.40A(2)]

There are occasions in business when the assessee employs his close relatives on very high salaries. He does it for reasons extraneous to business. Sometimes he wants to reduce his taxable income by paying high salaries to his relatives so that his tax burden is reduced. This type of situation can be met by the A.O. by acting under Section 40A(2) and disallowing all such expenditure which is unreasonable keeping in view the genuine business needs of the assessee. You will remember one important provision in this regard. The disallowance under this section is possible only when the payment has been made to a relative of the assessee or to one who has substantial interest in the business.

ii) Expenditure Exceeding Rs. 10,000 [Sec.40A(3)]

Under Section 40A (3) it has been stated that the assessee shall make payment towards all expenditure by way crossed cheque or a crossed demand draft if the amount exceeds Rs. 10,000. Where such payment has been made otherwise than the crossed cheque/demand draft, the amount will not be admissible. However, in the following cases the payment can be made otherwise than the crossed cheque, or demand draft.

1. Payment which under the contracts entered into before April 1, 1969 have to be made in cash.
2. Payment by book adjustment by the tax payer in the account of the payee against money due to the tax payer for any goods supplied or services rendered by him to the payee.
3. Payment made, in villages and towns having no banking facilities to persons ordinarily residing or carrying on business or profession in any such village or town.
4. Payments made to cultivators, growers or producers, for purchase of agricultural or forest produce, animal husbandry, products including hides and skins, products of dairy

or poultry farming, products of horticulture, or agriculture, fish or fish products of any cottage industry run without the aid of power.

5. Payments made to the Reserve Bank of India, State Bank of India, other banking institutions including co-operative bank and land mortgage banks, primary credit societies including agricultural credit societies, Life Insurance Corporation, Unit Trust of India and specified Financial Institutions.
6. Certain categories of payments made through the banking system, e.g. letters of credit, mail or telegraphic transfer, book adjustments and bill of exchange made payable only to a bank.
7. Payments of terminal benefits e.g. gratuity, retrenchment, compensation etc., to low-paid employees or to members of their families.
8. A residuary exception is also provided in respect of payments which could not be made by crossed bank cheque or draft due to exceptional or unavoidable circumstances, provided the tax payer furnishes evidence as to the genuineness of the payment and the identity of the payee.

iii) Provision for gratuity [Sec.40A(7)]

No deduction shall be allowed in respect of any provision made by the assessee for the payment of gratuity to his employees on their retirement or on termination of their employment. Such provision will be allowed only if payment has been made towards an approved gratuity fund.

iv) Contribution to Fund, Trust etc [Section 40 A (9)]

No deduction will be allowed in respect of any sums paid by the assessee as an employer towards contribution to any fund, trust, company, association of persons, body of individuals constituted for any purpose. However, contribution to approved superannuation fund is allowed.

v) Expenditure as Regards Income Tax Proceedings [Sec.40A(12)]

If an assessee incurs any expenditure by way of fees or other remuneration to non-employees or services in connection with any proceeding before any income tax authority or any court relating to tax penalty, interest, etc., the deduction will be limited to a maximum of Rs. 10,000 only.

Note: Sec.40A(12) has been omitted with effect from Assessment Year 1993-94.

11.3 DEEMED INCOMES

You have been told about various incomes that arise from many sources and which are taxed under the five heads prescribed under the Act. These incomes can be computed according to the provisions described in these units.

There are certain amounts which though the assessee does not declare as incomes, the Act creates them so. Apparently they are not incomes and cannot be categorised so, generally speaking. However, they are taxed under specific provisions described herein. They are deemed incomes.

We can illustrate certain situations which are supposed to be dealt with through the deeming provisions. There may be an assessee who purchases and sells goods without recording them in the books of accounts. He makes profit, say of Rs. 50,000. He desires to bring this money into account. He may deposit it in the name of someone who is his close relative and declare it as loan from him. He may also deposit such an amount in the name of some non-existent person and treat it as liability. The Assessing Officer while assessing the person might look into the balance sheet and the list of creditors properly. In case he concludes that the person supposed to be the creditor in this case either does not possess so much wealth as to lend him amount or the person supposed to be the creditor is non-existent, he will treat this amount as income of the assessee. There may be many such situations which are described below:

i) Cash Credit (Section 68)

Where the cash receipts are found credited in certain personal accounts which either do not exist or of the persons who do not have adequate means to justify such lending. These are, in short known as cash credits. Such cash credits are treated as income of the assessee in the year in which such entries have been detected. According to Section 68, the A.O. is authorised to treat such cash credits as income of the assessee if he does not offer proper and convincing explanation about the nature and a source of such amount.

ii) Unexplained Investment (Section 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 and the assessee is unable to offer convincing explanation to the A.O. the value of such investment will be deemed to be the income of the assessee of such financial year. This is according to Section 69.

iii) Unexplained Money, etc. (Section 69A)

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable articles and such things are not recorded in the books of account and he has also not been able to offer convincing explanation about the source of such money, the money and the value of the bullion, jewellery or other valuable articles will be deemed to be the income of assessee for such financial year. The A.O. treats the value of all these possessions as deemed income under Section 69-A.

iv) Amount of Investment etc., Not Fully Disclosed (Section 69-B)

There may be a situation where the person is found in possession of investment, bullion, jewellery and other valuable articles but is not able to explain the source of money fully. He explains but the A.O. is partly convinced about the adequacy of funds. Section 69-B authorises the A.O., to treat such not fully disclosed possessions as deemed income of the year in which they are found. You will notice that this Section takes care of a situation only where the value of possessions exceeds the amount recorded in the books of account maintained by the assessee.

v) Unexplained Expenditure, Etc. (Sec.69-C)

Section 69C authorises the A.O. to examine the expenditure of the assessee and see whether

he has recorded all such expenses in his books of account and that the amount on such expenditure has been spent from the recorded income. In case he finds that the expenditure has either not been recorded in the books of account and the explanation offered by the assessee is not convincing, he will treat this amount as deemed income of the assessee of the financial year in which the expenditure has been incurred.

vi) Amount Borrowed or Repaid on Hundi (Sec.69D)

Section 69D puts a restriction on those who borrow and lend money on hundi. It is stated that all the hundi transactions should be by way of an account payee cheque. Where any amount borrowed on a Hundi from or any amount due thereon is repaid to any person otherwise than through account payee cheque, the amount so drawn or repaid shall be deemed to be the income of the person borrowing or repaying the amount. It will be the income of the previous year in which the amount was borrowed or repaid. The amount repaid shall include the amount of interest paid on the money borrowed.

11.4 PROFITS CHARGEABLE TO TAX (SEC.41)

There are certain other amounts that are treated as income though strictly speaking from the accounting point of view they cannot be held to be incomes. It is only the operation of law that makes these amounts as taxable income. Some examples would be the recovery of debts or recovery of expenditure which has already been treated as income in an earlier previous year. Following items are includible as income under Section 41.

i) Bad Debts Recovered

Sometimes the assessee treats a particular debt as bad and convinces the AO about it who allows such bad debt as deductible in a particular previous year. However, it may happen that the debt which treated as bad is recovered partly or fully. The amount so recovered is treated as income of the previous year in which the recovery is made.

ii) Recovery of Loss or Payment of Expenditure

This is another situation where expenditure or loss once allowed if recovered subsequently is treated as income. For example, suppose the assessee pays customs or excise on certain goods and debits the same to profit and loss account. In this case, if due to some reasons, in the subsequent year the duty so paid is refunded the amount so refunded will be the income of the assessee in the year when the refund is obtained.

iii) Waiver of Claim by Creditor

If any creditor has waived his claim in favour of the assessee, the waived amount will be treated as taxable profit. The only precaution is that the amount payable to the creditor should be on account of some expenses which have been debited to P & L Account, of an earlier year. For example, the assessee has debited repair account by Rs. 10,000, and the amount is due to Ramesh. While making payment the full account is settled by a payment of Rs. 8,500. In this case if the payment is made in the same year, the repair will be credited by Rs. 1,500 and the balance will go to the P & L Account. In case the payment is made in the subsequent year, Rs. 1,500 will be shown

on the credit side of the P & L Account and taxed.

iv) Profit on Sale of Assets used for Scientific Research :

Where capital asset was purchased for scientific research and is sold without having been used for any other purpose excess amount of sale price added with the deduction allowed earlier over the capital cost of the asset is taxable as deemed income of the year in which sale was affected.

Check Your Progress - 1

List out certain deemed incomes.

.....
.....
.....
.....

Check Your Progress - 2

Mention the items which are includible as income under section 41.

.....
.....
.....
.....

11.5 VALUATION OF STOCK

Valuation of stock is an important factor in computing taxable profit from business. Correct profit cannot be ascertained unless the opening and closing stocks are valued properly. Though valuation itself does neither yield profits nor evaporate the resources of concern it does affect the taxable amount of the business profits. There are two popular methods-cost price and market value-of valuing the stock. So far as the adoption of any of these two methods is concerned two principles have now become well settled -

- (i) That the assessee is entitled to value his stocks either at cost price or at market price, whichever is lower.
- (ii) That the value of the closing stock must be the value of opening stock in the succeeding year. In other words, the assessee cannot close his accounts and value his stock at a particular figure and the next morning on the first day of the next year cannot value it at a different figure.

You will remember that the assessee is not allowed to change the method of valuation of stock

without the permission of the A.O. This restriction becomes necessary because the assessee is in a position to alter the profit figures by changing the method of valuation of stock offer.

11.6 METHOD OF ACCOUNTING

Under this head you should note the following:

- i) Income chargeable under the head 'Profits and Gains of Business of Profession' and 'Income from Other Sources' shall be computed in accordance with the method of accounting regularly employed.
- ii) The assessee has to follow that method of accounting which helps computation of profit correctly and properly.
- iii) The method of accounting cannot be changed by the assessee without the permission of the A.O.
- iv) Where the accounts have not been kept properly, the A.O. can reject the same and compute the profits according to his judgement.

11.7 MAINTENANCE OF ACCOUNTS (Section 44AA)

Every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decorating or any other profession (as noticed by the Board) shall keep and maintain such books of accounts and other documents as may enable the A.O. to compute his total income under this Act.

Every person carrying on business or profession (not referred to above) shall keep and maintain such books of accounts and other documents in the following cases:

- (i) If his income from business or profession exceed Rs. 25,000 or his total sales turnover or gross receipts in business or profession exceed Rs. 2,50,000 in any one of the three previous years preceding the previous year.
- (ii) Where the business or profession is newly set up in any previous year and the income from business or profession is likely to exceed Rs. 25,000 or his total sales turnover or gross receipts are likely to exceed Rs. 2,50,000 during such previous year.

The Board may having regard to the nature of the business or profession carried on by any class of persons prescribe the books of accounts and other documents (including inventory wherever necessary) to be kept and maintained, the particulars to be contained therein and the form and manner in which and the place at which they shall be kept and maintained.

Note: W.e.f. the A.Y. 1993-94 the above amount of Rs. 25,000 has been raised to Rs. 40,000 and the amount of Rs. 2,50,000 is raised to Rs. 5,00,000 (Finance Act, 1992).

i) Books of Accounts and Other Documents to be kept and Maintained u/s 44AA (3) by persons Carrying on Certain Professions (Rule 6F)

Every person carrying on legal, medical, engineering, architectural profession or the profession of accountancy, technical consultancy, interior decoration, authorised representative or film artist shall keep and maintain the books of accounts and other documents specified below:

- (i) A cash book
- (ii) A journal, if the accounts are maintained according to the mercantile system of accounting.
- (iii) A ledger
- (iv) Carbon copies of machine numbered bills wherever such bills are issued by the persons and receipts issued by the person. This will hold good only when the amount involved is Rs. 5 or more.
- (v) Original bills wherever issued to the person and receipts in respect of expenditure incurred by the person. Where such bills or receipts are not issued and the expenditure incurred does not exceed Rs.50, payment vouchers prepared and signed by the person must be kept.

ii) Medical Profession

A person carrying on medical profession shall in addition to the books of accounts and other documents specified above keep and maintain the following:

- (a) A daily register in Form 3C.
- (b) An inventory as on the first and last day of the previous year, of the stock of drugs, medicines and other consumable accessories used for the purpose of his profession.

The books of account and other documents specified above shall be kept and maintained by the person at the place where he is carrying on the profession or where the profession is carried on in more places than one, at the principal place of his profession.

Where the person keeps and maintains separate books of account in respect of each place where the profession is carried on, such books of account and other documents may be kept and maintained at the respective places at which the profession is carried on.

The books of account and other documents specified above shall be kept and maintained for a period of eight years from the end of the relevant assessment year. However cash book and ledger shall be kept for a period of sixteen years.

iii) Consequences of Failure to Maintain the Books of Accounts

Section 271 A provides that failure to maintain the accounts as above without reasonable cause may attract penalty. It shall not be less than 10% and not more than 50% of the amount of

tax, if any, which would have been avoided had the income returned by such person been accepted as the correct income.

11.8 IMPORTANT CIRCULARS ISSUED BY THE BOARD

We have stated earlier that while studying the law of income-tax it is necessary to understand the provisions of the Income-Tax Act, 1961 and the Income-Tax Rules, 1962 as amended upto-date. In addition we also must be aware of the latest thinking of courts on various issues. Another important direction in this regard is the thinking of the Government in respect of day to day issues. The Government functions through the Central Board of Direct Taxes. It is therefore, necessary for the student of income-tax to learn about the important circulars issued by the Board which affect the computation of taxable profits. We are giving here below certain important circulars which you should understand in proper perspective.

- i) Professional tax paid by a person carrying on a business or trade can be allowed to him as a deduction under section 37(1) Circular 16 of 18-9-1969.
- ii) Hotel charges of the proprietor or partners in respect of a tour undertaken for the purpose of procuring business are not allowable expenditure.
- iii) Diwali and Mahurat expenses are in the nature of business expenditure and there is no monetary ceiling provided that A.O. is satisfied that the expenses are not expenses of a personal, social or religious nature, letter of 3rd October, 1968.
- iv) Amount paid under the Own Your Telephone Scheme is allowed as deduction in the year of payment. Board's circular of 10th May, 1976.
- v) Premium paid on loss of profit policies is an allowable deduction. The payment received from the insurance company will be taxable income. Board's letter of 7th April, 1961.
- vi) Expenditure on advertisement in souvenirs is allowable. Board's letter of 28th June, 1976.
- vii) Annual listing fee paid to a stock exchange is allowable as of revenue nature. Board's circular 26-8-1965.
- viii) Membership fee paid to the Indian Institute of Foreign Trade is allowable.
- ix) Expenditure incurred by way of payment of commitment charge is allowable.
- x) Commission payable to bank for furnishing guarantees regarding deferred payment for import of plant and machinery is in the nature of capital expenditure and can be added to cost of plant and machinery.

11.9 COMPUTATION OF PROFIT/LOSS FROM BUSINESS OR PROFESSION

To summarise, the profit/loss from Business or Profession is to be computed as follows:

Net Profit or Loss as per P/L Account

A. Add. (Deduct in case of loss):

i)	Income-tax, surtax, penalty, etc.	...	
ii)	Personal expenditure including charity or presents	...	
iii)	Capital expenditure	..	
iv)	Expenses, allowances and payments not deductible under Sec. 40(a)(b)(ba)(i.e., payments made outside India without ensuring payment of income-tax, or wealth-tax)	...	
v)	Expenses not deductible under Sec. 40A (2) (3) (7) (9) (Ex: Excessive or unreasonable payments to relative of the assessee or to partner, directors, etc. of the business etc.,).	...	
vi)	Expenses not allowed u/s 43 B	...	
vii)	Depreciation (deductible separately)	...	
viii)	Investment deposit/allowance, and development allowance (deductible separately)	...	
ix)	Reserve or Provision for Bad Debts	...	
x)	Amounts transferred to any Reserve Fund	...	...
			...

B. Add : Other expenses debited to P/L Account, to the extent not admissible:

i)	Rent, rates, taxes, repairs and insurance premium not related to business/profession	...
ii)	Expenditure on scientific research or sums paid to scientific research association (Sec.35)	...
iii)	Expenditure on patent rights or copyrights (Sec.35A)	...
iv)	Expenditure on know-how (Sec. AB)	...
v)	Payments to agencies undertaking rural	

	development programmes (Sec.35 CCA)	...	
vi)	Payments to association, etc., for programmes as to conservation of natural resources (Sec.35CCB)	...	
vii)	Preliminary expenses (Sec.35D)	...	
viii)	Expenditure on prospecting and development of minerals (Sec.35E)	...	
ix)	Payment of bonus [Sec.36(1)(ii)]	...	
x)	Contribution to provident, superannuation and gratuity funds [Sec.36(1)(iv) and (v)]	...	
xi)	Entertainment expenditure [Sec.37(2) and (2A)]	...	
xii)	Advertisement expenditure [Sec.37(2B)]	...	
xiii)	Other expenditure on advertisement and maintenance of guest houses and travel of employees [Sec.37(3) and (4)]	...	
xiv)	Any other provision or reserve not allowed	...	...

C. Add : Amount not credited to P/L Account.

i)	Deemed Profits [Secs.41(1)(3) and (4)]	...	...
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D. Less : Expenses allowable but not shown on the debit side of the P & L Account and the income shown on the credit side of the P & L account, though belonging to other heads:

i)	Depreciation admissible	...
ii)	Investment deposit under section 32 AB.	...
iii)	Development allowance.	...
iv)	Capital expenditure on scientific research.	...
v)	Capital expenditure on family planning.	...
vi)	Expenses though belonging to earlier years but disallowed then because of non-pay-	...

	ment.	...	
vii)	Interest on securities.	...	
viii)	Rental Income	...	
ix)	Dividends	...	
x)	Capital gains.	...	
xi)	Refund of Income Tax.	...	
xii)	Bad debts recovered if they are not allowed in the year claimed and written off.	...	...

TAXABLE PROFITS:

11.10 ILLUSTRATIONS

- i) M/s Dwarakanath Chemicals is a proprietary concern and is engaged in the medicine preparations in Indian Style. Particulars of their Income and Expenditure Account for the year ending 31st March, 1992 are given below:

	Rs.		Rs.
Raw materials used	1,11,000	Total receipts	5,40,500
Advertisements	1,20,000	Rental income	6,000
Scientific Research Exps:		Bad debts recovered	1,000
Revenue 10,000			
Capital <u>70,000</u>	80,000		
Commission to dealers	86,000		
Embezzlement by cashier	3,000		
Advance Income-Tax paid	1,000		
Sundry Expenses	10,000		
Depreciation Reserve	30,000		

Bad Debts	5,000	
Bad Debts Reserve	10,000	
Surplus	91,500	
	<u>5,47,500</u>	<u>5,47,500</u>

Other relevant information is as follows:

Rs.

1. Advertisements include cost of permanent boards distributed amongst the agents

1,00,000

2. Admissible depreciation

2,200

Compute gross total income of the Dwarakanath Chemicals for the assessment year 1992-93.

Solution

	Rs.	Rs.
Profits as per Income and Expenditure Account		91,500
Add : Expenses not allowed :		
Advance income-tax paid	1,000	
Depreciation reserve	30,000	
Bad debts reserve	10,000	
Capital expenditure on advertisement	<u>1,00,000</u>	<u>1,41,000</u>
		2,32,500
Less : Admissible depreciation		<u>22,000</u>
		2,10,500
Less : Rental income to be separated		<u>6,000</u>
Profit from business		<u>2,04,500</u>
Income from house property :		
Rental Income	6,000	

Less : Local taxes

Annual Value

6,000

Less : 1/6 for repairs

1,000

Taxable income from house property

5,000

Computation of Gross Total Income

Income from house property

5,000

Profit from business

2,04,500

Gross Total Income

2,09,500

Notes:

- (1) Embezzlement by cashier is allowed as it is incidental to business.
 - (2) No reserve is allowed : In view of this, depreciation reserve and bad debts reserve are not allowed.
 - (3) Bad debts recovered are taxed like any other business gains.
 - (4) Permanent boards being capital in nature, the expenditure thereon is not allowable. However, they are certainly subject to depreciation. These are classified as fixtures and general rate of 10% is to be applied.
 - (5) It is assumed that the item admissible depreciation takes care of allowable depreciation on boards too.
- ii) Following is the summary of cash transactions of Mr. Raj Kumar, a practising Chartered Accountant of Bangalore.

	Rs.		Rs.
Office expenses	10,000	Audit fees	19,210
Rent paid for office	5,000	Consultation	10,000
Salaries and wages	12,050	Appellate Tribunal Appearance	15,000
Stationary & Printing	1,000	Miscellaneous	20,000

Subscription to Institute of Chartered Accountants	3,000	Securities (Gross)	9,000
Books bought	1,300	Rent received	10,000
Travelling expenses	5,800	Presents from Clients	10,000
Interest on bank loan	3,000		
Donation to National Defence Fund	5,000		
Surplus	47,060		
	<u>93,210</u>		<u>93,210</u>

Loan from bank was arranged for constructing a house in which, Mr. Raj Kumar resides. Municipal value of the house is Rs.8,000 with local taxes of Rs. 800 per annum. 1/4th of the travelling expenses are found to be not allowable. Compute professional income and other incomes of Mr. Raj Kumar.

Solution

	Rs.	Rs.
Gross Receipts from Profession:		
1. Audit fees	19,210	
2. Consulation	10,000	
3. Appellate Tribunal appearance	15,000	
4. Miscellaneous receipts	20,000	
5. Presents from Clients	<u>10,000</u>	74,210
Admissible Expenses:		
1. Office expenses	10,000	
2. Rent Paid	5,000	
3. Salaries and wages	12,050	
4. Stationery and Printing	1,000	

5. Subscription	3,000	
6. Travelling expenses (5,800-1,450)	4,350	
7. Books bought	1,300	36,700
Taxable gains		<u>37,510</u>
Income from House Property:		
Let out house : Rent received		10,000
Less: Local taxes		<u>—</u>
	Annual Value	10,000
Self occupied house		NIL
Annual Value of both houses		<u>10,000</u>
Less : Repairs 1/6th of Annual value	1,667	
Interest on bank loan	3,000	4,667
Taxable income from house property		<u>5,333</u>
Computation of Gross Total Income		
1. Income from house property		5,333
2. Profits and Gains from Profession		37,510
3. Income form other sources:		
Interest on securities		9,000
Gross total Income		<u>51,843</u>

Notes:

- Books are treated as plant. In case the actual cost of plant does not exceed Rs. 5,000 , it is to be allowed in full.
- Interest on bank loan has been deducted from annual value of house property for which the loan amount was utilised.
- Donation to National Defence Fund is not business expenditure.
- Presents from clients are taxable as income from profession.

11.11 SUMMING UP

In the previous unit we have discussed the expenses which are expressly allowed and which are not allowed. There are certain expenses which are not deductible under certain circumstances while computing profits and gains from business. They are unreasonable expenses, provision for gratuity, expenditure as regards income tax proceedings, etc. Cash credit, unexplained money, amount of investment not fully disclosed are treated as deemed incomes, though the assessee does not declare them as incomes. There are certain other amounts which are treated as income under the Section 41. At the end of the unit the computation of Profit/Loss from business or profession is summarised.

11.12 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Cash Credit, ii) Unexplained Investment, iii) Unexplained Money, iv) Unexplained Expenditure, v) Amount borrowed on Hundi.
2. i) Bad debts recovered, ii) Recovery of Loss or payment of expenditure, iii) Waiver of claim by creditor, iv) Profit on the sale of asset used for scientific research.

11.13 MODEL EXAMINATIONS QUESTIONS

1. Essay Questions

Answer the following in about 30 lines each:

1. Under what circumstances payment of an amount exceeding Rs. 10,000 could be made otherwise than by way of crossed cheque/demand draft?
2. Explain the provision and necessity thereof when the deduction on account of certain expenses is allowable only when they are actually paid?
3. What provisions would you follow regarding the valuation of stock?
4. State what type of accounting books have to be maintained by a doctor?
5. From the following Profits and Loss Account of M/s Deepak Stores for the period ended 31-3-1992, ascertain the taxable profits from business and the Gross Total Income, for the Assessment Year 1992-93.

Expenditure	Rs.	Income	Rs.
Office Salaries	15,000	Gross Profit	87,000
Proprietor's salary	7,500	Profits on sale of residential house	30,000

Interest on proprietor's capital	3,000	Bad debts recovered (not allowed as deductions by A.O. in previous year for lack of proof)	7,500
General expenses	7,500	Interest on Government Securities (Gross)	6,000
Bad debts	3,000		
Advertisement	6,750	Dividends from Agricultural Companies (Gross)	3,000
Fire Insurance premium	3,000	Interest on Post-Office 3 1/2% National Savings Certificates	3,000
Depreciation	6,000		
Reserve for sales tax	15,000		
Income-Tax on last assessment	6,000		
Advance Income-Tax paid	3,000		
Donations to Delhi University	1,500		
Legal Charges for defending a suit for alleged breach of a trading contract	750		
Motor Car Expenses	1,500		
Net Profit	57,000		
	<u>1,36,500</u>		<u>1,36,500</u>

General Expenses include Rs.1,000 paid as compensation to an old employee whose services were terminated as his continuing in service was considered detrimental to the profitable conduct

of the company's business and Rs.200 by way of help to a poor university student. The depreciation, is found to be in excess by Rs.1,800.

The advertisement cost includes one new sign board of Rs.1,500, calenders and diaries Rs.1,500. Motor car expenses include Rs.500 attributable to private use of the car. The assessee has received demand notices of sales-tax for earlier years amounting to Rs.10,000 and he has not disputed the liability.

7. Dr. Mrs. Lalitha Sunder a medical practitioner of Hyderabad prepared her Income and Expenditure Account for the year ending 31st March, 1992 as follows:

Expenditure	Rs.	Income	Rs.
Cost of Medicines	10,300	Dispensary receipts	20,430
Salaries and wages	12,000	Consulation charges	12,300
Laboratory expenses	5,000	Visits	9,250
Furniture bought	8,000	Pathological tests	8,500
Rent of Clinic	5,000	Honorarium from Civil Hospitals	12,000
Donation to Jan Sangh	1,100	Interest on Post Office Savings Bank A/c	200
Subscription to All India Medical Association	200	Gifts from patients	5,000
Household expenses	8,800		
Car expenses	6,000		
Surplus	11,280		
	<u>67,680</u>		<u>67,680</u>

1/3rd of the car expenses are incurred on private use. Gifts from patients include an amount of Rs 2,000 which Mrs. Lalitha has received from her father in personal capacity. You are required to compute her total Income.

II. Short Questions

Answer the following in about 15 lines each:

1. Explain deemed incomes.
2. How would you treat unexplained money, etc.?
3. How would you treat waiver of claim by creditor?
4. What type of accounting is expected to be kept by a businessman?

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UNIT -12: DEPRECIATION AND OTHER ALLOWANCES

Contents

- 12.0 Aims and Objectives
- 12.1 Introduction
- 12.2 Depreciation
- 12.3 Necessary Conditions for Claiming Depreciation
- 12.4 Method of Computation of Depreciation
- 12.5 Unabsorbed Depreciation
- 12.6 Terms Explained
 - 12.6.1 Actual cost
 - 12.6.2 Written Down Value
- 12.7 Development Allowance
- 12.8 Illustrations
- 12.9 Summing Up
- 12.10 Check Your Progress: Model Answers
- 12.11 Model Examination Questions

12.0 AIMS AND OBJECTIVES

The objective of this unit is to explain you depreciation and other aspects of depreciation which are to be taken into account for computing business profits.

After completing the unit, you should be able to:

- Explain depreciation and necessary conditions for claiming depreciation;
- describe the method of computing depreciation; and
- explain the terms related to depreciation.

12.1 INTRODUCTION

Depreciation is to be taken into account for computing business profits and professional gains. It is necessary to compute it properly and deduct it while finding out the taxable profit. In this unit we will study the computation of depreciation and all other aspects of depreciation.

12.2 DEPRECIATION

Depreciation is a necessary element of cost. Unless it is taken into account for computing business profits and professional gains, correct taxable amount could not be arrived at.

We are aware that depreciation is a wear and tear of asset plus obsolescence due to improvement in technology. However, you will appreciate that it is not possible to quantify the wear and tear and obsolescence. If we leave it to the assessee to decide for themselves as to how much depreciation they would like to claim, there will not be any uniformity and different assessee would claim different amounts by way of depreciation. It is, therefore, necessary that the Department should prescribe the rates of depreciation for different types of assets so that there is no guess work as regards the claims for depreciation. The Income Tax Rules, 1962 prescribe rates of depreciation.

12.3 NECESSARY CONDITIONS FOR CLAIMING DEPRECIATION

i) Ownership

Depreciation is allowed to those assessee who own the assets. Suppose a particular asset has been obtained on hire, then only hire charges would be admissible. In case the asset has been got under hire purchase or instalment basis, depreciation will be allowable in view of specific instructions of the Board in this regard.

ii) Actual use

The question of allowing depreciation arises only when the asset has been actually used in the previous year. In case a particular asset has been bought and installed during the previous year but not used even for a day, depreciation in respect of that will not be allowed.

Similarly, where the asset has been partly used for business and partly for purposes other than business, depreciation will be allowed in respect of that part of the asset which has been used for business. For example, a house is used for business to the extent of one-third and two thirds is used for private purpose. Depreciation in respect of this house will be available only for one-third of the house.

Where the asset involved has been put to use in the business or profession for a period of less than 180 days in the previous year, it will be entitled to 50 per cent of the prescribed rate of depreciation. This is effective from the A.Y. 1992-93.

iii) Depreciable Assets

Depreciation is allowed only in respect of building (office and factory both), plant and machinery, furniture and fittings only. The term 'plant' includes vehicles, books, scientific equipment, ship, etc.

iv) Animals

In case there is a business which maintains some animals too, there is no provision of any depreciation being allowed in respect thereof. However, when an animal dies, the whole amount

will be written off.

v) When Assets are Sold, etc.

Depreciation is not allowed in a year in which the asset has been sold, discarded, destroyed or demolished.

vi) Prescribed Particulars

Depreciation will be allowed only when the assessee supplies prescribed particulars in respect of asset. Where such particulars are not available with the A.O., depreciation cannot be allowed. These particulars are cost of acquisition, depreciation allowed in all these years, written down value, cost of improvement, etc.

vii) Basis of Depreciation

While learning book keeping and accountancy, you have known of two basis of allowing depreciation, straight line method and written down value method. Under straight line method, depreciation is allowed at a rate which is always applied to the original cost. It means that the cost of the asset will be zero after some time. Under the written down value method, depreciation is calculated on the reduced value of the asset year after year. For example, if the cost of acquisition is Rs.100 and the value of the asset will be zero after ten years. On the other hand under the written down value method, it will be Rs.10 in the first year, Rs.9 in the second year, Rs.8.10 in third year and so on.

Depreciation is admissible in respect of buildings, machinery, plant and furniture owned by the assessee and used for the purposes of his business or profession.

12.4 METHOD OF COMPUTATION OF DEPRECIATION

A new system of allowing depreciation on block of assets has been introduced from the Assessment Year 1988-89. Accordingly depreciation will be allowed in respect of 'block of assets' calculated at the specified percentage on the written down value of such block of assets as shown below.

Block of Assets	Depreciation allowance as percentage of written down value
I. Buildings	
(1) Building other than those covered by (3) mainly used for residential purposes	5
(2) Buildings which are not used for residential purposes and not covered by (3)	10
(3) (i) Buildings used as hotels	20

(ii) Buildings with dwelling units each with plinth area upto 80 Sq.mtrs.	20
(iv) Purely temporary erections	100

II Furniture and Fittings

(1) Rate applicable to items not covered by (2) below	10
(2) Furniture and fittings used in hotels, restuarants, boarding houses, schools, colleges, libraries, meeting halls, cinema houses, etc., and those let on hire for marriage and other functions	15

III. Machinery and Plant

(1) Items not covered by (2) and (3)	25
(2) Cars acquired on or after 1-4-90	20
(3) Aeroplanes, motor buses and lorries, taxis, air and water pollution or solid waste control equipment, etc.	40
(4) Cinematograph, films, energy saving devices, instrumentation and monitoring system water-heat recovery equipment, cogeneration systems, electrical equipment burners, mechanical vapour recom-pres-sors, coal-based producer gas plants, floor mills rollers, gas cylinders, wooden match framers in match factories, plant used in mineral oil concerns in field operations whether above or below ground tubs wind-ing ropes and safety lamps used in mines and quarries, sugar works rollers and renewal energy devices.	100

IV. Ships

(1) Ocean-going	20
(2) Vessels operating on inland water not covered by (3)	10
(3) Speed boats	20

Assets Sold: Money payable in respect of assets sold, discarded, demolished or destroyed will be reduced from the written down value of the block.

Buildings: Buildings meant for low paid employees of industrial undertakings will be entitled to depreciation of 20% as against the general rate of 5 per cent for residential buildings and 10 per cent for non-residential buildings.

Plant and Machinery: There are four rates of depreciation prescribed for plant and machinery.

Certain assets are eligible for 100 per cent depreciation in the initial year itself. In addition, there are three more rates namely 25 per cent, 20 per cent, and 40 per cent.

Machinery costing not more than Rs.5,000: Where the actual cost of any plant and machinery does not exceed Rs.5,000 the actual cost thereof shall be allowed as a deduction in respect of the previous year in which such machinery or plant is first put to use by the assessee for the purposes of his business or profession.

Ocean going ships: Since ocean going ships will also be included in a block of asset, depreciation will be allowable in respect of such ships not on straight line method as has been done whether to put on written down value method.

According to Income-Tax Rules, 1962, depreciation is allowed in respect of all assets on the basis of written down value method.

Restriction on Depreciation for Companies only: The Taxation Laws (Amendment) Act, 1991 has proposed a restriction on claim of depreciation by companies as under:

- (a) Depreciation as calculated under this Act is to be restricted to 75% and this restricted amount can be debited to P&L Account.
- (b) There will be no restriction on depreciation of any item of Plant & Machinery whose cost does not exceed Rs.5,000 and 100% depreciation is allowed.
- (c) For W.D.V. purposes only restricted amount of depreciation shall be deducted.

This amendment has come into force from Assessment Year 1991-92.

12.5 UNABSORBED DEPRECIATION

The amount of depreciation if cannot be absorbed by the existing profits, is carried forward to the next year for set-off against future profits. The unabsorbed portion of depreciation so carried to the next year is known as unabsorbed depreciation. If in the next year also it cannot be set-off fully, the unabsorbed amount will be carried forward and there is no time limit for such carrying forward.

Restriction on Carry Forward of Depreciation: With effect from Assessment year 1992-93, the Finance Act, 1992 has put a restriction on set off of unabsorbed depreciation for domestic companies. In future full unabsorbed depreciation cannot be adjusted. The revised procedure is:

- a) Only 2/3rd of brought forward depreciation can be set off from the income of the previous year 1991-92. The balance 1/3 rd of B/F depreciation and any unadjusted portion out of 2/3rd of depreciation shall be added to the depreciation of previous year 1992-93 and treated as depreciation of 1992-93 and shall be set off accordingly and this procedure shall continue in succeeding previous years.
- b) This restriction is not applicable if the amount of B/F depreciation is less than Rs.1,00,000.

Illustration

The written down value of plant and machinery with Vijayawada Ltd., is Rs. 3,50,000 as on 1st April, 1991 and the rate of depreciation allowable is 25 percent. Profits before depreciation for the previous year 1991-92 amount to Rs.75,000. You are required to compute unabsorbed depreciation.

Previous Year 1991-92	Assessment Year 1992-93	
	Rs.	Rs.
Profit available for depreciation		75,000
Written down value of the asset	3,50,000	-
Depreciation at 25%	87,500	87,500
Written down value for 1991-92	2,62,500	
Unabsorbed depreciation		12,500

12.6 TERMS EXPLAINED

12.6.1 Actual Cost

'Actual Cost' means the actual cost of an asset to the assessee as reduced by that portion which has been met directly or indirectly by any other authority or person. For example, where an asset is brought for Rs.25,000 and Rs. 5,000 is spent on its installation and in case the Government subsidises the purchase by paying Rs.10,000 the actual cost of asset to the assessee would be Rs.20,000 being, Rs.25,000 + 5,000 - 10,000.

i) Assets first used for Scientific Research and later in Business

Where any asset has been first used for scientific research pertaining to the business of the assessee and later used in business itself, the cost of such asset will be its original cost of acquisition minus the amount of depreciation allowed during the period of its use in scientific research.

ii) Assets acquired by way of Gift or Inheritance

In this case the actual cost to the assessee shall be the written down value of the asset in the previous year in which it is acquired or the market value thereof, whichever is less.

12.6.2 Written Down Value

The term written down value means as follows:

- In the case of assets acquired in the previous year, the actual cost to the assessee.
- In the case of assets acquired before the previous year, the actual cost to the assessee less all depreciation allowed under this Act.

(c) In the case of the block of assets:

(i) In respect of any previous year relevant to Assessment Year 1992-93 the aggregate of written down values of all the assets falling within the block of assets at the beginning of the previous year adjusted as under:

(A) By the increase equal to the actual cost of any asset falling within that block, acquired during the previous year, and

(B) By the reduction of the money payable in respect of any asset falling within that block which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, However, the amount of such reduction shall not exceed the written down value as increased under (A) above.

(ii) In respect of any previous year relevant to Assessment Year 1992-93, the written down value of the block of assets in the immediately preceding previous year as reduced by the depreciation actually allowed in respect of the block of assets in relation to the said preceding previous year and as further adjusted by the increase or reduction referred to in (i) above.

Deemed written down value

If assessment is done on a successor of a business or profession, the written down value of any asset or block of assets will be the amount which would be the amount of written down value in case the assessment had been made on the predecessor.

If any previous year, any block of assets is transferred-

- (a) by a holding company to its subsidiary or vice-versa, where the subsidiary is a hundred percent subsidiary;
- (b) by an amalgamating company to the amalgamated company in a scheme of amalgamation (the latter being an Indian Company).

Then the actual cost of the block of assets in the case of the transferee company shall be the written down value of the block of assets to the transferor company, as reduced by the depreciation actually, allowed in the said previous year.

Plant

Plant includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purpose of business or profession.

Check Your progress - 1

From the following particulars given below, calculate the amount of depreciation admissible during the year ending 31.3.1992.

Fixed Assets	Written down value on 1-4-91	Additions during the Year	Rate of Depreciation
Building (Factory)	10,00,000	—	10%
Building (Non-Factory)	2,00,000	—	5%
Plant & Machinery	30,20,000	4,00,000	25%
Motor Cars	65,000	—	25%
Furniture	10,000	—	10%

Part of the non-factory buildings whose written down value was Rs.1,10,000 on 1.4.91 was destroyed by fire on 5.6.91 and Rs.1,00,000 was received from the insurance company.

The additions to the plant and machinery were all new and installed on 1.6.1991.

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12.7 DEVELOPMENT ALLOWANCE (33A)

This concession is permissible in case of those assesseees who are engaged in Tea Plantations and who have invested money on preparing land for planting tea bushes. It is aimed at encouraging the expansion of tea plantation.

Development allowance is allowed in respect of planting of tea bushes in India on land which had never been used for tea plantations earlier. It is necessary that the land must be owned by the assessee.

Development allowance is allowed at the rate of 50 percent of cost of planting of tea bushes.

Actual cost of planting

The actual cost of planting means the aggregate of the following:

- (i) Cost of preparing land,
- (ii) Cost of seeds, cutting and nurseries,
- (iii) Cost of planting and replantings,

- iv) The cost of upkeep thereof for the previous year in which the land has been prepared and three successive previous years next following such previous year.

The amount so arrived at shall be reduced by the portion of the cost if any as has been met directly or indirectly by any other person or authority:

Where the cost exceeds the following prescribed limits, the excess shall be ignored.

- (i) Rs. 40,000 per hectare in respect of land situated in a hilly area in the district of Darjeeling, or
- (ii) Rs. 35,000 per hectare in respect of land situated in a hilly area of any other district.
- (iii) Rs. 30,000 per hectare in any other area.

The above deduction will be allowed only in respect of the plantation completed after 31-3-1965 and before 1-4-1990.

12.8 ILLUSTRATIONS

ABC & co., follows financial year as its accounting year. The company has got three items of plant and machinery in respect of which the depreciation rate applicable for the Assessment Year 1992-93 is 25%. For the Assessment Year 1992-93, the written down value of the three items before allowing depreciation was as under:

Item A	Rs. 2,00,000
Item B	Rs. 2,50,000
Item C	Rs. 4,00,000
Total	<u>8,50,000</u>

Supposing that all the above three items fall into the same block of asset carrying a depreciation rate of 33.33% for the Assessment Year 1991-92, calculate depreciation and written down value for the two Assessment Years 1991-92 and 1992-93.

Solution

Assessment year 1991-92

Asset	Written down Value at the beginning of A.Y. 1991-92	Depreciation for 1991-92	Written down value at the beginning of A.Y. 1992-93
Item A	2,00,000	66,660	1,33,334

Item B	2,50,000	83,333	1,66,667
Item C	4,00,000	1,33,333	2,66,667
Aggregard WDV at the beginning of AY 1992-93			5,66,668

Assessment Year 1992-93:

Aggregate WDV at the beginning	Rs. 5,66,668
Less: Depreciation at 25%	Rs. 1,41,667
Written down value at the beginning of the AY 1993-94	Rs. 4,25,001

12.9 SUMMING UP

Depreciation is wear and tear plus obsolescence. It is to be deducted from business profits to get correct taxable amount. Certain conditions are to be fulfilled for claiming depreciation. A new method of computing depreciation has been introduced from the AY 1988-89. Accordingly depreciation is allowed in respect of 'block of assets'. It is calculated as a specified % on the written down value of such block of assets. The depreciation which cannot be absorbed by the existing profits, is carried forward for set-off against future profits. The other allowances i.e., Investment allowance, Development allowance are discontinued from the AY 1991-92.

12.10 CHECK YOUR PROGRESS: MODEL ANSWERS

1. Calculation of Depreciation

<u>Group-I: Building</u>	<u>W.D.V.</u>	<u>Rate</u>	<u>Rs.</u>
i) Building (Factory)	10,00,000	10%	1,00,000
ii) Building (Non-Factory)	2,00,000		
(-) Money realised	1,00,000		
	<u>1,00,000</u>	5%	5,000
<u>Group-II: Furniture</u>			
Furniture	10,000	10%	1,000
<u>Group-III: P&M</u>			
(i) P&M (old)	30,20,000		
(ii) Motor cars	<u>65,000</u>		
	30,85,000		

(+) Additions	4,00,000		
	<u>34,85,000</u>	25%	<u>8,71,250</u>
Total Depreciation			<u>9,77,250</u>

12.11 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following in about 30 lines each:

1. How is depreciation calculated under the new scheme of block of assets?
2. How do you arrive at the actual cost and written down value of depreciable assets?
3. XYZ Ltd, owns the following assets on 1st April, 91.

Asset	Actual Cost	Written down value on 1-4-1991	Rate of Depreciation for A.Y. 1992-93
Building			
A	12,00,000	9,50,000	10%
B	9,50,000	7,00,000	5%
C	7,00,000	5,50,000	5%

During the previous year 1991-92, the company acquired the following.

Assets	Cost	Date of acquisition	Rate of Depreciation
Building			
A	10,00,000	22nd April, 1991	10%
B	5,00,000	25th June, 1991	5%

Determine the written down value and amount of depreciation for the Assessment years 1991-92 and 1992-93.

4. Calculate Depreciation of the following assets:

	W.D.V. on 1.4.91	Rate of Depreciation
Building A	4,00,000	5%
Building B	3,00,000	10%
Building C	5,50,000	10%
Furniture	20,000	10%
P & M A	5,00,000	40%
P & M B	2,00,000	25%
P & M C	1,80,000	100%

Following assets have been purchased and installed during the PY 1991-92.

		Rate of Depreciation
Plant D	2,50,000	40%
Plant E	3,00,000	25%
Building D	4,00,000	10%
Building E	2,00,000	5%

Following assets have been sold during the year.

	Rs.
Building B	5,00,000
Plant A	2,20,000

Building 'A' was renovated by spending Rs.75,000. Rs.50,000 has been spent on Machinery B to make it fit for new technique of production.

II Short Questions

Answer the following in about 15 lines each:

1. Define the term 'plant'.
2. What do you understand by 'block of assets'?
3. Explain unabsorbed depreciation.

APPENDIX

The Eleventh Schedule

1. Beer, Wine and other alcoholic spirits.
2. Tobacco and preparations, such as Cigars and Cheroots, cigarettes, bidies, smoking mixtures for pipes and cigarettes: chewing tobacco and snuff.
3. Cosmetic and toilet preparations.
4. Tooth paste, dental cream, tooth powder and soap.
5. Aerated waters in the manufacture of which blended flavouring concentrates in any form are used.
6. Confectionery and chocolates.
7. Gramophones, including record players, and gramophone records.
8. Cinematograph films and projects.
9. Photographic apparatus and goods.
10. Office machines and apparatus such as typewriters, calculating machines, cash registering machines, cheque writing machines, intercom machines and teleprinters.

Explanation

The expression "office machines and apparatus" includes all machines and apparatus used in offices, shops, factories, workshop, educational institutions, railway stations, hotels and restaurants for doing office work, for data processing and for transmission or reception of messages.

11. Steel furniture, whether made partly or wholly of steel.
12. Safes, strong boxes, cash and deed boxes and strong room doors.
13. Latex foam sponge and polyurethane foam.
14. Crown corks, or other fitting of cork, rubber, polyethylene or any other material.
15. Pilter-proof caps for packaging or other fittings of cork, rubber, polyethylene or any other material.

UNIT - 13: CAPITAL GAINS (SECTIONS 45 TO 55)

Contents

- 13.0 Aims and Objectives
- 13.1 Introduction
- 13.2 Chargeability
- 13.3 Terms Defined
- 13.4 Exemptions
- 13.5 Computation of Taxable Capital Gains
- 13.6 Illustration
- 13.7 Summing Up
- 13.8 Check your Progress: Model Answers
- 13.9 Model Examination Questions

13.0 AIMS AND OBJECTIVES

The objective of this unit is to explain you the computation of taxable capital gains. Several questions like, what is a capital asset? When do we earn capital gains? Is capital gain justified? How should we invest the amount we receive on the sale of a capital asset so as to reduce capital gain tax?

After going through this unit, you should be able to:

- describe the chargeability aspect of capital gains,
- explain different terms relating to capital gains,
- identify the capital gains which are not taxable,
- Compute taxable capital gains and help a person in reducing his capital gains tax through planned investment of funds.

13.1 INTRODUCTION

Capital Gain is the fourth head of income. It is a gain on the transfer, etc., of a capital asset. It cannot be a regular source of income and therefore one need not be a particular type of assessee to pay tax on capital gains. For example, a salaried assessee deriving income on sale of capital assets will pay tax in the same way as is done by another conducting business.

Really speaking, capital gains should not be taxed. You might have come across examples when a house property or land bought in 1960 for say Rs.10,000 might fetch Rs.3,00,000 today. Is

it really a gain or is the gain on account of a substantial fall in the value of rupee? You will agree with me that most of the time the capital asset fetches a large fortune because the value of rupee has gone down to a few paise compared with what it was about two decades ago. It is therefore really not the tax on gains, only a portion of the acquisition is being appropriated by the tax authorities by way of capital gains tax. However, the fact remains that capital gains are subject to tax under the law.

13.2 CHARGEABILITY

Any profits or gains arising from the transfer of a capital asset effected in the 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 the transfer took place.

The chargeability stated above is the subject matter of Section 45. If we analyse the above material we find the following essential characteristics.

- (a) Profit or gain must arise on transfer,
- (b) The transfer must be of a capital asset,
- (c) The gain will be deemed to be the income of the previous year, in which the transfer took place.

The following have also been held to be capital assets:

1. The goodwill of a business.
2. Shares in a Company.
3. Partner's shares in a firm.
4. Leasehold rights.
5. Dealership rights.
6. Tenancy rights under a Tenancy Act.

To further illustrate, if there is a transfer of an asset which is not a capital asset, there will not be taxable profit and gain. Similarly, if the capital asset moves from one party to the other but such movement is not considered to be a transfer in the eyes of law, any gain arising there from will not be taxable. It is, therefore, necessary to understand the various terms to chargeability.

13.3 TERMS DEFINED

Capital Asset

'Capital Asset' means property of any kind held by the assessee whether it is connected with his business or not. It has a very wide meaning and would include all kinds of property whether movable or immovable, tangible or intangible. It is however, stated in the relevant section that the following are not included in the term 'Capital asset'

- (a) Any stock in trade, consumable stores or raw materials held for the purpose of business or profession.
- (b) Personal effects, that is to say, movable property held for personal use by the assessee or any member of his family dependent on him. It is interesting to learn that jewellery is considered to be a capital asset and any profit arising thereon will be capital gain.
- (c) Agricultural land in India other than which is situated in urban areas.
- (d) 6% Gold Bonds, 1977 or 7% Gold Bonds, 1980 or National Defence Gold Bonds, 1980 issued by the central Government.
- (e) Special Bearer Bonds, 1991 issued by Central Government.

Agricultural Land in Urban Areas

It is the land lying within the jurisdiction of a Municipality, Municipal Corporation, Notified Area, Town Area, Cantonment Board etc. But they must have a population of 10,000 or more as per the last census. Profit arising on the sale of such land is taxable as capital gains.

In addition, the Central Government has assumed power to declare any area for the levy of capital gains tax if it lies within a distance of 8 Kilometers from the local limits of the municipality etc, by a notification in the Official Gazette.

The following have also been held to be Capital assets:

1. The goodwill of a business.
2. Shares in a Company.
3. Partners' shares in a firm.
4. Leasehold rights.
5. Dealership rights.
6. Tenancy rights under a Tenancy Act.

Short-term Capital Assets

Short-term asset means capital asset held by an assessee for not more than 36 months immediately preceding the date of transfer. Capital gains arising out of the transfer etc, of such an asset known as short-term capital gains.

However, in the case of shares held in a company, the qualifying period has been reduced to 12 months.

Long-term Capital Gains

Assets, which are not short term capital assets are long-term capital assets. Gains arising on

the transfer etc., thereof will be termed as long term capital gains for tax-purposes. It is important to learn that the tax incidence differs on these two types of capital gains.

Transfer

Transfer includes the sale, exchange, relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law. Sales conducted by an auctioneer, Commissioner or receiver will come within the meaning of transfer. Transfer takes place only on the date of execution of the sale deed and not on concluding the agreement to sell. As stated above, even the acquisition by the Government of any asset will amount to transfer and any profit therefrom will be taxable.

Transactions Not Regarded as Transfers (Sec.47)

The following transactions are not regarded as transfers, and therefore, gains arising therefrom will not be subject to tax:

- (a) Any distribution of capital assets on the total or partial partition of H.U.F.
- (b) Transfer of capital asset under a gift, will or an irrevocable trust.
- (c) Any transfer of a capital asset by a company to its wholly owned Indian subsidiary company.
- (d) Transfer of capital assets by a wholly owned subsidiary company to the Indian holding company.
- (e) Transfer of capital asset in the scheme of amalgamation by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company.
- (f) Any transfer by a share-holder in a scheme of amalgamation of a share or shares held by him in the amalgamating company.
- (g) Any transfer of a capital asset being bonds or shares referred in subsection (1) of Section 115 AC made outside India by a non-resident to another non-resident (w.e.f. 1st June, 1992).
- (h) Any transfer of agricultural land in India effected before the 1st day of March, 1970.
- (i) Any transfer of a capital asset being any work of art, archaeological, scientific or art collection, books, manuscripts, drawing, printing, photograph or print to the Government or 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 to be of national importance or to be renowned throughout any State or States.
- (j) Any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates of a company into shares or debentures of that company will not be treated as transfer. It means such conversion will be exempt from capital gain tax. (w.e.f. AY

Cost of Acquisition

Capital gain is calculated by deducting the cost of acquisition from transfer price. It is therefore, necessary to learn and understand the term 'cost of acquisition' carefully. It is easy to know the cost of acquisition when one buys the assets himself and sells them. But it is not so always. Sometimes we get assets on partition of family, partnership firm or on liquidation of company. It may also be possible that certain assets are obtained by way of inheritance. The law takes care of all such situations. The provisions are as under:

i) Different Modes of Acquisition

Where the capital asset has been acquired by the assessee in one of the following ways, the cost of acquisition of the asset in the hands of the assessee will be the cost of acquisition to the previous owner:

- (a) Total or partial partition of the Hindu Undivided Family
- (b) Gift or Will
- (c) Succession, inheritance or devolution
- (d) Dissolution of a firm, body of individuals, etc.
- (e) Liquidation of a company
- (f) Transfer to a wholly owned subsidiary company

ii) Determination of cost of acquisition (Sec. 55(2)):

For the purposes of Sec. 48 and 49 'Cost of acquisition' shall be as follows:

- a) Goodwill of a business: The amount for which it has been acquired by the assessee from the previous owner.
- b) Shares or stock of company: Their cost of acquisition is calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.
- c) Any other capital Asset:
 - (i) Where it is acquired before 1-4-1974, either its original cost of acquisition or its fair market value as on 1-4-1974 at the option of the assessee.
 - (ii) Where it is acquired by the assessee in any of the ways specified under section 49 (1) and where it is acquired by the previous owner before 1-4-1974: its cost of acquisition to the previous owner or the fair market value on 1-4-1974 (at the option of the assessee).
 - iii) Where it became the property of the assessee on the distribution of the capital

assets of a company on its liquidation: the fair market value of that asset on the date of distribution.

Note: As per the Finance Act, 1992 the above provision has been amended as follows: The cut off date will be 1-4-1981 instead of 1-4-1974. Further the option given to the assessee earlier is dropped. Consequently the original cost of acquisition will be taken to be the value of asset as on 1-4-1981. This is w.e.f. the A.Y. 1993-94.

iii) Shares in an Amalgamated Company [Sec. 49(2)]

When two or more companies amalgamate, they are known as amalgamating companies. The company that comes into existence or the company that continues to function thereafter is known as the amalgamated company. Under any scheme of amalgamation, the shareholders of the amalgamating company will surrender their holding and will be allotted shares in the amalgamated company. The cost of shares in the amalgamated company will be deemed to be the cost of shares of the amalgamating company. To illustrate, Nazir Hussain holds 100 shares in Company X which he bought at a price of Rs. 25,000, X gets amalgamated with Y Ltd., and on amalgamation Nazir Hussain is allotted 200 shares of Y Limited.

Now Nazir Hussain sells these shares at a price of Rs. 28,000. In this case, though the cost of acquisition of shares in Y Ltd., is not known it will be deemed to be the cost of acquisition in X. The capital gains therefore will be computed as below:

Selling price of 200 shares in Y Ltd.	Rs.	28,000
Cost of acquisition of 100 shares in X	Rs.	25,000
Capital Gain	Rs.	<u>3,000</u>

(iv) Special Provision for Computing Cost of Acquisition in the Case of Depreciable Assets

From the assessment year 1988-89, a new Section 50 has been enacted in conformity with the new scheme of depreciation to be allowed on the written down value of block of assets. As per this, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed under Income Tax Act, the computation of capital gains and determination of cost of assets acquired under any special mode (Section 49) will be subject to the following conditions:

1. If full value of consideration received or accruing as a result of the transfer of the asset or assets falling within the same block of assets during the previous year exceeds the aggregate of the following, the excess shall be deemed to be capital gains arising from the transfer of short term capital assets:
 - (a) expenditure incurred wholly and exclusively in connection with such transfer or transfers.
 - (b) The written down value of the block of assets at the beginning of the previous year; and

- (c) the actual cost of any asset falling within the block of assets acquired during the previous year.

2. Where any block of assets cease to exist as such, for the reason that all the assets in that block are transferred during the previous year, the written down value at the beginning of the previous year will be the actual cost for that block. It will be increased by the actual cost of any asset falling within that block of assets acquired by the assessee during the previous year and the income received or accruing as a result of such transfer shall be deemed to be the capital gain arising from the transfer of short term capital assets.

v) Cost of acquisition of non-depreciable asset bought before 1-4-1974:

Where a non-depreciable asset is bought before 1-4-1974, an option is given to the assessee to opt for either the original cost of acquisition or the fair market value of the asset on 1-4-1974.

Note: W.e.f. the A.Y. 1993-94, the cut off date has been shifted from 1-4-1974 to 1-4-1981.

vi) Adjustment of Advance Money Received [Sec. 51]

You might have come across a situation where the transaction is settled for the sale of some house etc. At the time of setting the bargain, the purchaser is required to pay some advance to the seller which will be forfeited if the buyer fails to fulfil the conditions of purchase. For example, Nair agrees to sell his house for an amount of Rs. 5,00,000 to Reddy, who pays an amount of Rs. 50,000 by way of an advance agreeing to pay the balance amount within a period of one month. He fails to pay the balance amount within the said period. It is therefore natural that the contract will terminate and the amount paid by Reddy will be forfeited by Nair.

Assuming that the cost of acquisition of this house at the hands of Nair was Rs. 2,75,000, it will now get reduced by Rs. 50,000 which he has forfeited having received it by way of advance money from Reddy.

vii) Cost of previous Owner Not Ascertainable [Sec.55(3)]

In case where the assessee has obtained a capital asset through some mode and has not paid any amount for transfer, we should know the cost of the asset to the previous owner. Where the cost for which the previous owner acquired the capital asset cannot be ascertained, fair market value of the asset on the date on which the capital asset becomes the property of the previous owner will be the cost of the asset to the previous owner.

viii) Reference to Valuation Officer [Sec.55 A]

Do you think it is easy or possible for a person like you or me to value various assets, like ornaments, land and buildings, precious stones, furniture and so on. Your answer would be an emphatic No. For valuing all such items we need the services of experts. Those experts are there in the society and they are given licence by the Board to do the valuation work by charging nominal fees. Assesses are free to make use of their services for furnishing valuations to the tax authorities.

On the other hand the tax authorities are also in need of such expertise so that they are in a position to collect tax correctly. The Board has therefore appointed many experts in the department

under the designation Valuation Officers. The Assessing Officers may refer the cases of valuation to these officers whenever need be.

Under Section 55A, the Assessing Officer may refer the valuation of the capital asset to Valuation Officer in the following cases:

- (a) Where the value of the asset has been estimated by a registered valuer and the assessee's claim is in accordance with it but the A.O. is of the opinion that the value so claimed is less than the fair market value.
- (b) In any other case where the A.O. is of the opinion that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than 15 per cent of the value claimed or by more than Rs. 25,000.

To illustrate, assessee Banerjee claims that he has sold the house for Rs. 2,50,000 and the A.O., however, feels the figure stated by Banerjee is not correct, he may refer the valuation to the Valuation Officer only if he feels that the fair market value of the house is not less than Rs. 2,87,500 that is Rs. 2,50,000 plus 15 percent of 2,50,000 (37,500).

ix) Cost of acquisition of shares or debentures [Sec.49 (2A)]

The cost of acquisition of shares or debentures of a company acquired in consideration of conversion of debentures, debenture-stock or deposit certificates, shall be deemed to be the cost of original debentures, debenture-stocks or deposit certificates converted (w.e.f. A.Y.1991-92).

Cost of Improvement (55(1)(b)):

Cost of improvement shall be as follows:

1. Goodwill: Cost of improvement for this asset shall be taken to be nil.
2. Any other capital asset: Where the capital asset became the property of the previous owner or the assessee before 1-4-1974 and the fair market value of the asset on that day is taken as the cost of acquisition at the option of the assessee, all expenditure of a capital nature incurred in making any addition or alterations to that asset on or after the said date by the previous owner or the assessee.
3. In other Cases: All expenditure of a capital nature incurred by the assessee in making any additions or alterations to the capital asset after it became his property and where the capital asset became the property by any of the modes specified in section 49 (1), by the previous owner.

Note: W.e.f. the A.Y. 1993-94 the cut off date has been changed from 1-4-1974 to 1-4-1981. Consequently the cost of improvement will be taken to be the cost of improvement made after this date.

Check Your Progress - 1

What are the types of capital gains?

13.4 EXEMPTIONS

We have stated that gains arising on the transfer of capital asset are termed as capital gains taxable under the Act. It has also been emphasised that where the gain arises on the transfer of an asset but the said transfer does not come within the term 'transfer' as defined in the Act, the gains arising thereon would not be taxed.

We are describing the capital gains which are not taxable under the Act, and will not form part of total income:

i) Gains from Transactions Not Regarded as Transfer

Capital gains arising out of the transactions enumerated in section 47 of the Act (which are not regarded as transfers) are not taxable.

ii) Distribution of Assets by a Company on Liquidation

Where the assets of a company are distributed to its shareholder on its liquidation, such distribution shall not be regarded as transfer for purposes of chargeability.

iii) Capital Gains Arising on Transfer of a Residential House [Sec.53]

Long term capital gains arising on the transfer of a residential house will be exempt from tax in cases where the consideration received or accruing on the transfer does not exceed Rs. 2,00,000. In cases where such consideration exceeds this amount, the capital gains would be exempted proportionately. You will remember one limitation here. If the assessee owns any other residential house on the date of such transfer, the exemption under this provision will not be available to the assessee.

For example, cost of acquisition of a residential house to an assessee Daruwala is Rs. 1,75,000. He keeps this house for a period of five years and it is on record that he does not own any other residential house in his ownership. He sells this house for Rs. 2,00,000 and makes long term capital gains of Rs. 25,000. It is fully exempted.

On the other hand if he sells this house for Rs. 2,50,000 the exempted capital gains will be computed as below:

	Rs.
Selling Price	2,50,000
Less : Cost of acquisition	<u>1,75,000</u>

Capital Gains	75,000
Less exempted capital gains:	
$5,000 \times \frac{2,00,000}{2,50,000} = 60,000$	60,000
Taxable Capital gains	15,000

Note: However, this exemption will be dropped w.e.f. the A.Y.1993-94.

iv) Profit on Sale of Property Used for Residence [Sec.54]

The relevant section in this case is 54 and the important points to note are as follows:

- Gains arising from the transfer of a long term capital asset being buildings used as residential house and lands appurtenant thereto.
- The assessee must invest the amount of capital gains in purchasing a residential house within a period of one year before or two years after the date of transfer.
- In case the assessee intends constructing a house, he should do so within a period of three years from the date of transfer.
- This exemption is allowed to an individual assessee.
- In case the amount so reinvested is less than the capital gains, the excess of capital gains over the amount invested will be taxable.
- The new house so acquired or constructed will not be transferred for a minimum period of three years from the date of purchase or construction.

It may sometimes happen that the assessee is compelled to sell the house so acquired or constructed within a period of three years from the date of purchase or construction. In that case the following provisions will operate:

- If the cost of the new house is less than the capital gains arising on the sale of the old house, then for computing capital gains on the sale of the new house the cost of acquisition will be nil.
- In case the cost of the new house is equal to or more than the capital gains arising on the sale of the old house, the cost of the new house will be reduced by the amount of capital gains exempted last time for computing capital gains on the sale of the new house.

Illustration

Ratnakar sells his old house for an amount of Rs. 4,50,000, earning long term capital gains of Rs. 2,35,000 in the year 1986. He constructs a new house within a period of three years at a cost of Rs. 2,30,000. The new house so constructed is sold within a period of two years at a price of Rs.

3,50,000. Explain capital gains tax provisions.

	Rs.
Capital gains on the sale of old house	2,35,000
Capital gains utilised in constructing a new house and thus exempt	2,30,000
Taxable capital gain on the sale of the old house	<u>5,000</u>
Sale proceeds of the new house	3,50,000
Cost of acquisition of this house being nil as it was constructed out of exempted capital gains	Nil
Short-term Capital gains to be taxed on the sale of new house	<u>3,50,000</u>

v) Capital Gains on transfer of agricultural land not to be charged in certain cases [Section 54-B]

Capital gains arising on the transfer of agricultural land are exempt, subject to the following conditions:

- The land so transferred was being used for the agricultural purposes by the assessee or his parents for a period of atleast two years immediately preceding the date of transfer.
- The assessee has to purchase another land for use in agriculture within a period of two years from the date of such transfer.
- The capital gains arising on the transfer of his agricultural land is thus invested in buying other land for being used for agricultural purpose.
- If the full amount of capital gains is spent in buying this land, no tax will be charged on the capital gain. If the amount spent is less than the capital gains, the unspent portion of such gain will be put to tax.
- The agricultural land so bought out of the capital gains must not be transferred, etc., within a period of three years from the date of purchase. If it is sold etc., within this period, not only the fresh capital gains will be put to tax but the exemption granted earlier will also be taxed.

vi) Capital gain on Compulsory Acquisition of Land and Building Not to be charged in certain cases (Sec.54D)

Section 54 D grants tax relief from capital gains tax for persons who own industrial undertakings and who derive capital gains from compulsory acquisition of land and buildings. The relief is available subject to the following conditions:

- The land and building form part of an industrial undertaking of the assessee.

- (b) It has been so used for atleast two years preceding the date of compulsory acquisition.
- (c) The assessee has to purchase any other land and building within a period of three years from the date of transfer. A building may also be constructed within this period.
- (d) The newly acquired land and buildings must be used for the old industrial undertaking or for setting up a new industrial unit.
- (e) The new asset should not be transferred by the assessee for a period of three years from the date of acquisition.
- (f) The capital gains are not chargeable to tax to the extent they are utilised in purchasing the land and building.

Taxation of Capital Gains in case of compulsory acquisition of Asset [Sec 45 (5) (a)]

Where the capital gain arises from the transfer of a capital asset by way of compulsory acquisition under any Law, then such Capital Gain will be chargeable, as income under the head 'Capital Gains' of the PY in which the compensation first received.

vii) Capital gains on transfer of long-term capital assets (Sec.54 E):

The amount of Capital gains arising from the transfer of any capital asset is exempt from tax, if the following conditions are satisfied:

1. The capital asset should be held by the assessee for more than 36 months before the date of transfer. However, it need not be used by the assessee during this period.
2. The capital gain arising from the transfer before 1-4-1992 should have been invested in specified assets within a period of six months from the date of transfer.
3. Where the amount so invested is less than the net consideration, the exemption will be restricted proportionately.
4. The newly acquired specified assets should be held by the assessee for not less than 3 years.
5. The specified assets are, as follows:
 - (i) Securities of the Central Government which the Government by notification in the Official Gazette, specify in this behalf.
 - (ii) Special series of units of the Unit Trust of India which the Central Government may by notification in the Official Gazette specify in this behalf.
 - (iii) Such National Rural Development Bonds as have been notified above or as may be notified in this behalf under this clause by the Central Government.
 - (iv) Such debentures issued by Housing and Urban Development Finance Corporation Ltd., as the Central Government may by notification in the Official Gazette

specify in this behalf.

(v) Notified bonds issued by a public sector company.

In case the investment in these specified securities is less than the amount of net consideration, the exemption will be allowed proportionately.

Net consideration = Total consideration - Transfer Expenses

viii) Capital Gains on Transfer of Certain Capital Assets not to be charged in case of investment in Residential House (Sec.54F)

With a view to encouraging house construction, it is now provided in section 54F that where any capital gains arise from the transfer of any "long term capital asset" (excluding building and land appurtenant thereto) and the taxpayer purchases within a year before or two year after the date on which the transfer took place or constructs within a period of three years after the date of transfer, a residential house, the capital gain arising from the transfer will be treated in a concessional manner given below:

- (a) If the cost of the house that has been purchased or constructed is equal to or more than the net consideration in respect of the capital asset transferred, the entire capital gain arising from the transfer will be exempt from tax.
- (b) If the cost of the newly acquired house is less than the consideration in respect of the asset transferred, the exemption from long term capital gain will be granted proportionately on the basis of investment of net consideration either for purchase or construction of the residential house.
- (c) This concession is not available in a case where the assessee owns on the date of the transfer of the original asset any residential house.
- (d) Where the assessee purchases or constructs any other residential house within the period aforesaid, the exemption under this provision, if allowed shall stand forfeited.
- (e) If a taxpayer transfers newly acquired residential house within three years of its purchase or construction, the amount of capital gains arising from the transfer of the original asset, which was not charged to tax, shall be deemed to be the income of the year in which the new asset is transferred and such income shall be charged to tax under the head 'Capital gains' relating to long term capital asset.
- (f) Concession under this section is granted to an individual assessee and Hindu Undivided Family only.

ix) Capital gains on the transfer of assets in cases of shifting of industrial undertaking from urban area (Sec.54 G).

W.e.f. the A.Y. 1988-89, Sec.54 G provides exemption to capital gains arising on the transfer of assets in the case of shifting of industrial undertaking from the urban area subject to the following conditions:

1. The capital asset (being plant, machinery, land or building) used for the purpose of an industrial undertaking situated in an urban area is transferred.
2. The assessee has within a period of one year before or three years after the date of transfer:
 - i) Purchase a new machinery or plant for the purpose of business of the industrial undertaking so shifted.
 - ii) Acquired building or land or constructed building for the purpose of business of the undertaking.
3. The amount of exemption shall be restricted to the cost of the new asset and the expenses incurred thereto.
4. The new asset so acquired shall be held by the assessee for a period of three years.

Extension of time for acquiring new asset or depositing or investing amount of Capital gain (Sec.54 H) :

Where the transfer of asset is by way of compulsory acquisition and the payment of compensation is delayed, the period of acquiring the new asset u/s. 54, 54 B, 54 D, 54 E and 54 F shall be reckoned from the date of receipt of the amount of compensation. Where the compensation is received before 1-4-1991, the above period shall be extended upto 31-12-1991.

13.5 COMPUTATION OF TAXABLE CAPITAL GAINS (SEC.48)

The amount of taxable capital gains (or capital loss) in respect of transfer of any capital asset is computed as follows:

1. Ascertain the full value of consideration received or accruing on transfer of the capital asset.
2. Deduct any expenditure incurred wholly and exclusively in connection with transfer (for example, brokerage, commission, stamp duty, registration charges etc. as borne by the assessee, including expenses on travel undertaken for the purpose of transfer).
3. Deduct cost of acquisition of the capital asset, including cost of improvement thereto.
4. The balance will be capital gains or capital loss relating to transfer of the capital asset.

Long-Term Capital Gain : (Sec.48(2))

If the gain is a long term capital gain, then a deduction equal to 100% of that gain will be allowed, where it does not exceed Rs. 15,000. Where the capital gain exceeds Rs. 15,000, the rates of deduction shall be as follows:

Status of Assessee	Rates of deduction in respect of longterm capital gains relating to buildings or lands or any rights therein or gold, bullion or Jewellery	Rates of deduction in respect of longterm capital gains relating to any other capital assets
	Rs.	Rs.
Company	15,000 + 10% of Balance	15,000 + 30% of Balance
Any other Assessee	15,000 + 50% of Balance	15,000 + 60% of Balance

Notes:

1. Where long term capital gains arise from various assets, the deduction of Rs. 15,000 shall be effected from the capital gains arising from land and building, etc... Thereafter the balance, if any, of the said Rs. 15,000 shall be allowed as deduction against long term capital gains arising on sale of other capital assets.
2. In cases of compulsory acquisition, the threshold deduction will be restricted to a total amount of Rs. 15,000 in relation to the initial compensation as well as additional compensation received in subsequent years.

Long-Term Capital Loss: (Sec.48(3)): Long-Term Capital loss, where it exceeds Rs. 15,000, shall also be scaled down by the same percentage of deduction as is applicable to long-term capital gains.

New Method of computation of Capital Gains from 1993-94 Assessment Year:

Finance Act, 1992 amends the provisions relating to computation of long-term capital gains/loss w.e.f. the A.Y.1993-94 on the following lines.

1. The cost of acquisition and the cost of improvement of the asset will be linked to cost inflation index which will be notified by the Central Government. Long-term capital gains will be computed by deducting from the full value of the consideration, the expenditure incurred in connection with the transfer, the indexed cost of acquisition and the indexed cost of improvement.
2. The cut off date for valuing assets acquired in earlier year will be 1-4-1981 in place of 1-4-1974.
3. Starting with 1981-82 as the base year, the Central Government will notify the cost inflation index for every year having regard to 75 per cent rise in consumer price index for urban and non-manual employees. The cost of acquisition will be adjusted with reference to the rate applicable for the relevant year. There will be similar indexation of cost of improvement.

4. W.e.f. 1993-94 A.Y., no deduction will be allowed u/s 48(2) for long-term capital gains.

Check Your Progress - 2

List out the deduction allowed u/s 48 (2) from long-term capital gains in case of other than company assesseees.

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13.6 ILLUSTRATION

Goyal bought a house for Rs. 2,30,000 on 15th December 1971 from a builder in Vijayawada. He incurred the following expenses on improvement thereof:

Motor Garage	Rs. 25,000 in 1972
Renovation	Rs. 45,000 in 1973
Overhead tank	RS. 25,000 in 1980

The house was gifted to his son in the year 1983. It was once again renovated by his son spending a sum of Rs. 50,000. He then sold it in December 1991, for Rs. 5,20,000. You are required to compute the capital gains on the sale of house for the previous year 1991-92 assuming that the fair market value of the house on 1-4-1974 was Rs. 4,10,000.

	Rs.	Rs.
Cost of Acquisition to		
Mr. Goyal in 1971		2,30,000
Cost of improvement 1972	25,000	
1973	45,000	70,000
		<u>3,00,000</u>

Cost of Acquisition Rs. 3,00,000 or the fair market value as on 1-4-1974 i.e. Rs. 4,10,000 whichever is more.

	Rs.
Actual Cost	4,10,000
Add Cost of overhead tank in 1980	<u>25,000</u>

Cost of acquisition in the year 1990		4,35,000
Add. Cost of renovation		50,000
Cost of acquisition and cost of improvement		4,85,000
Selling Price		5,20,000
Long term Capital Gains		35,000
Less : Exemption u/s 53	$\frac{2,00,000 \times 35,000}{5,20,000}$	$\frac{13,462}{21,538}$
Less : Deduction u/s 48(2)		
Initial Rs. 15,000 - 100% -	Rs. 15,000	
Balance of 6,538 - 50% -	3,268	18,269
Taxable capital Gains		3,268

Note: It is assumed that the assessee had no other house on the date of transfer.

Check Your Progress - 3

Mr. Sudheer sold the following properties during the previous year 1991-92

- Jewellery costing Rs.40,000 (which was acquired in June 1989 was sold for Rs. 50,000 in May '91'
- Residential House at Hyderabad. It was inherited by him in 1961. Sale Price Rs. 1,50,000. Fair Market Value on 1-4-1974, Rs. 50,000. Cost of improvement after 1-4-1974 was Rs. 12,500. Expenses on transfer Rs. 12,500.
- House hold furniture costing Rs. 2,000 in 1981 was sold in 91 May for Rs. 3,000.
- Self-cultivated land was sold for Rs. 1,00,000 on 1-1-1992 and its cost in 1971 was Rs. 40,000. He purchased a new land for his own cultivation for Rs. 75,000 within one year. Compute his taxable capital gains for the Assessment Year 1992-93.

.....

13.7 SUMMING UP

Capital gains is the fourth head on income. There are two types of capital gains-short term and long term. Short term capital gains are taxed like any other income whereas long term capital gains are subject to concessional treatment. Where capital gains are reinvested in the construction of new houses they are exempted. Similarly if the net proceeds of the capital asset could be invested in certain specified securities, exemption would be available. Capital gains exemptions at a glance are given in the chart enclosed here with.

13.8 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Short-term Capital Gain : Gain on asset held by an assessee for a period of 36 months.
- ii) Long-term capital gain : Gain on asset held by an assessee for a period exceeding 36 months.
2. i) RS 15,000 of Long-term Capital gain in every case.
- ii) In case of Long-term capital gain from land and building, Gold or Jewellery Rs. 15,000 + 50% of the balance.
- iii) In case of long-term capital gain from any other assets Rs. 15,000 + 60% of the balance.

Note: Initial deduction of Rs. 15,000 is allowed only once during one previous year.

3. Computation of Taxable Capital Gains of Mr. Sudheer in the AY - 1992-93.

Short-term capital Gain

i) Jewellery : Sale Price	50,000	
Cost	40,000	10,000

Long-term Capital Gain

ii) Residential house : Sale Price	1,50,000	
Expenses on transfer	12,500	
Net consideration	1,37,500	
(-) Fair Market value	50,000	
Cost of improvement	12,500	62,500
LT Capital Gain	75,000	
Exempted U/S 53	75,000	
Taxable Capital gain		NIL

iii) Household Furniture is not a capital asset, hence its gain is not taxable

iv) Self cultivated land

S.P.	1,00,000	
Cost	40,000	
	60,000	

Exempted U/S 54

60,000

Capital Gain

Nil

Income under the head Capital Gains

10,000

13.9 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following in about thirty lines each:

1. How is the cost of acquisition determined in relation to a Capital asset?
2. Enumerate exempted Capital gains.
3. How would you determine the cost of acquisition in the following cases:
 - i) Shares in an amalgamated company
 - ii) Asset bought before 1-4-1974
4. Write a note advising the assessee how he can reduce his tax liability by investing the sale proceeds in particular channels.

II. Short Questions

Answer the following in about fifteen lines each:

1. Explain the chargeability of capital gains.
2. Enumerate the items which are not included in the term 'Capital Asset'.
3. When is reference made to the Valuation Officer?
4. How is long term gain taxed?
5. How is agricultural land in urban areas treated for purpose of capital gains tax?
6. Name the transactions which do not constitute transfer.

CAPITAL GAINS EXEMPTIONS AT A GLANCE

Section No.	Particulars	Applicability	Investment of NC or CG	Mode of Investment	Time Limit	Extent of concession	Remarks
53	Exemption of capital gains from a residential house	Individuals & HUFs	Not required	Not applicable	Not applicable	TC being - upto Rs. 2,00,000 : full exemption - more than Rs. 2 lakhs: $\text{Cap. gains} \times \frac{2,00,000}{\text{TC}}$	Assessee must not own any other residential property on the date of transfer
54	Profit on sale of property used for residence	Individuals & HUFs	CG	- purchase of new house - construction of new house - Deposit in a specified a/c	One year before or two yrs. after date of transfer 3 yrs. from date of transfer Before the date of furnishing of return of Income	Amount utilised in purchase or construction of new residential house, plus amount, so deposited	No restriction on owning any house: Restriction of 3 yrs. on transfer of new asset or utilisation of deposit
54B	Capital gains on transfer of agr. land not to be charged in certain cases	All assees	CG	- purchase of new agr. land - deposit in a specified a/c	2 yrs. from date of transfer Before due date of furnishing return of Income	Amt. utilised in purchase of new agricultural land plus amt. so deposited	Restriction of 3 yrs. on transfer of new agr. land or utilisation of deposit amount within specified time limit
54D	Capital gain on compulsory acquisition of land & bldg. not to be charged in certain cases	All assees	CG	- purchase of any other land or bldg. - construction of any other bldg. - deposit in a specified account	3 yrs from date of transfer -do- Before due date of furnishing return of Income	Amt. utilised in purchase of land / bldg. or construction of a bldg. plus amt. so deposited	Newly acquired land / bldg. to be used for shifting old unit or setting up a new unit; restriction of 3 yrs. on transfer of new asset or utilisation of deposit
54E	Cap. gains on transfer of cap. assets not to be charged in certain cases	All assees	NC	Investment in specified assets	6 months from date of transfer	If cost of new asset is - more than or equal to NC: full exemption - less than NC: $\text{cap. gains} \times \frac{\text{cost of new asset}}{\text{NC}}$	No transfer or conversion of the specified asset within 3 yrs. of its acquisition
54F	Cap. gains on transfer of certain cap. assets not to be charged in case of investment in residential house	Individuals & HUFs	NC	- purchase of a residential house - construction of a res. house - deposit in a specified a/c	1 yrs. before or 2 yrs. after date of transfer 3 yrs. from date of transfer Before due date of furnishing of Income	If cost of new asset is - more than or equal to NC: full exemption - less than NC: $\text{Cap. gains} \times \frac{\text{cost of new asset}}{\text{NC}}$ (cost of new asset includes deposit, if any in a specified a/c.)	Assessee not to own another residential house on date of transfer of OA; OA excludes bldg. and land appurtenant thereto; 3 yrs. restriction on transfer of new asset or utilisation of deposit
54G	Exemption of cap. gains on transfer of assets in cases of shifting of Industrial under taking from urban areas	All assees	CG	- Appropriation for specified purposes - Deposit in a specified a/c	1 Yr. before or 3 yrs. from the date of transfer Before due date of furnishing of return of Income	Extent of appropriation plus amt. so deposited	Restriction of 3 yrs. on transfer of new asset or utilisation of deposit

TC: Total consideration
NC: Net consideration
CG: Capital gains
OA: Original asset

UNIT - 14 : INCOME FROM OTHER SOURCES

[SECS 56 TO 59]

Contents

- 14.0 Aims and Objectives
- 14.1 Introduction
- 14.2 Chargeability
- 14.3 Deductions of Tax at Source
- 14.4 Deductions for Expenditure Incurred
- 14.5 Amounts Not Deductible
- 14.6 Profits Chargeable to Tax
- 14.7 Computation of Income from Other Sources
- 14.8 Illustrations
- 14.9 Summing Up
- 14.10 Check Your Progress : Model Answers
- 14.11 Model Examination Questions

14.0 AIMS AND OBJECTIVES

The objective of this unit is to explain you the income chargeable under the head "Income from Other Sources" and deductions available under this head.

After going through this unit, you should be in a position to :

- list out various incomes chargeable under this head :
- explain the deductions available under this head :
- compute income from other sources.

14.1 INTRODUCTION

'Income from other sources' is the residuary head. All those various incomes which cannot be taxed in the heads described earlier are put to tax under this head. You will also appreciate that it is very difficult for any one to list various items headwise exhaustively. It is therefore necessary that some head is kept under which all the residuary items are put to tax. Let us illustrate our ideas. You know that rental income from house property is taxed under the head 'Income from house property' provided the assessee is the owner of the house property. Suppose there is a person X who has taken a property on hire but he sublets it and makes a clean profit in the bargain each

month. Can we tax the profit under the head 'income from house property' as X is not the owner of the property? Can we tax it under business? Can we tax it under 'salaries'? etc., We will say 'No'. It is therefore to be taxed here under the last head namely, income from other sources.

'Income from other sources' is the last head of income and is all inclusive. Whatever incomes cannot be accommodated in earlier heads are grouped here. With the completion of this unit you should be in a position to calculate taxable incomes under various heads stated earlier.

14.2 CHARGEABILITY

I. General Chargeability

Chargeability of income under this head is governed by Section 56. It contains two sub-sections. The first sub-section, that is, Sec.56 (1) is residuary and general in the real sense of the term. Accordingly income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under this if it is not chargeable to income tax under any of the heads discussed earlier.

To summarise, if the income is to be taxed and if it does not find place under any of the heads specified earlier will be put to tax under this head.

Examples of Income Chargeable under this Head

- (a) Income from grant of mining rights.
- (b) Income from royalties.
- (c) Income from bustee lands.
- (d) Income from markets, fisheries, rights of ferry.
- (e) Income from grant of grazing rights.
- (f) Income from sub-letting.
- (g) Income from licence to take away earth.
- (h) Director's fees.
- (i) income from examinations by a professional.
- (j) Income of an Ayurvedic practitioner from a dramatic troupe maintained by him.
- (k) Income from forest produce.
- (l) Gratuitous periodical payments received by a member of the family from a company in which the family was holding substantial shares.
- (m) Unexplained investments in the construction of house property.
- (n) Interest on bank deposits.

- (o) Income arising from the lease of a factory.
- (p) Income from letting out of cinema theatres.
- (q) Interest other than 'interest on securities.'
- (r) Salary or pension received from a foreign Government.
- (s) Ground rent received.
- (t) Agricultural income received from outside India.
- (u) Income from hidden sources.
- (v) Casual income in excess over Rs. 5,000
- (w) insurance Commission.

II. Specific Chargeability

It is right to say that all residuary incomes are chargeable under this head. However, Section 56 (2) specifies the following incomes that are chargeable under this head.

- (i) Dividends.
- (ii) Any winning from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.
- (iii) Interest on Securities.
- (iv) Income from machinery, plant or furniture belonging to the assessee and let on hire, if the income is not chargeable under the head 'Profits and Gains from business or profession.'
- (v) When an assessee lets on hire machinery, plant or furniture belonging to him and also buildings and such letting is inseparable, the income from such letting is taxable under this head.

Income from units of the Unit Trust of India is taxable under this head as it amounts to dividend which is specifically taxable here.

Salaries received by an MP is taxable under this head according to the Circular of the Board.

i) Dividends Defined

You might have heard the term dividends often. It is related to shares. Profit distribution to shareholders is termed as dividends. It is paid to shareholders in proportion to their holding. In popular meaning it is always the cash distribution that is included in dividends. But even if the profit is distributed by the company in kind, it will be taxed as dividends. The term has been

discussed in detail in section 2(22). Accordingly the following distributions included in the term 'dividend.'

(i) Distribution out of Profits and Releases of Assets

The amount will be termed as dividends only when it comes out of profits and not from capital. Another important element of dividend is that the payment of dividend must involve release of assets by the company to its shareholders.

(ii) Distribution of Debentures, Deposit Certificates etc. to Shareholders.

- (a) Sometimes the company may not be able to distribute dividends in cash. It may distribute debentures or deposits certificates etc. to its shareholders. It will amount to dividend.
- (b) Where a company issues bonus shares to its preference shareholders it will be taxed as dividends in the year in which the bonus shares are issued to them. However, it is important to see that in both these situations it is necessary that the company possesses sufficient accumulated profits to cover such distribution.

(iii) Distribution on Liquidation of the Company

The distribution by a company to its shareholders on its liquidation will be treated as dividends provided it is attributable to accumulated profits immediately before its liquidation.

(iv) Loan to Share holders

The following three types of payments are covered within the term "dividend."

- (1) Any sum given by way of advance or loan to a shareholder.
- (2) Payment to any other person on behalf of a shareholder.
- (3) Payment to any other person for the benefit of a shareholder.

In order that the amount be treated as dividend under this sub-clause, all the following three conditions are to be satisfied.

- (i) The company must not be a widely held company.
- (ii) The shareholder must have substantial interest in the company in the sense that he must possess at least 20% of the equity capital of the company.
- (iii) There must be sufficient accumulated profits at the time of making the said payment to be treated as a dividend.

(v) Assessment of Dividends

- i) Dividends are taxed in the year in which they were declared and not when they fall due. Assuming that the company does not declare dividends for four continuous years and

declares it in the fifth year : the whole dividend will be taxed in the fifth year alone. As regards interim dividend it is taxed in the year when dividend warrants are received. Mere declaration in this respect will not be sufficient for taxability.

- ii) The dividend may be paid in cash or in kind and both ways it is taxable.
- iii) It does not affect the liability of the shareholder to pay tax whether or not the dividend has been paid out of tax-free income. It is the nature of receipt and not the payment that is material.
- iv) Dividends distributed by an Indian Company outside India are deemed to accrue or arise in India and therefore taxable here.
- v) Dividends received from a foreign company will be taxable if received in India.
- vi) A few deductions are allowed in respect of dividends included in total income. They are discussed in unit titled 'Deductions from Gross Total Income' :
- vii) The gross income from dividends i.e., the amount actually received by the shareholder plus the amount of income tax, if any, deducted at source-is to be shown in the assessment of shareholder, the amount so deducted at source is subtracted from the gross tax payable by him.

For the above purpose the net dividend is to be grossed up by the following formula.

$$\text{Net dividend} \times \frac{100}{100 - \text{rate of tax deducted at source}} = \text{Gross Dividend}$$

(vi) Exemption and Deduction Available in respect of Dividend Income

Dividends are taxable in the hands of all assesseees under the last head except the persons and authorities who have been exempted from payments of tax under Section 10. A list of such persons has been given in sixth unit, but for the sake of ready reference, it may be stated as follows:

- (a) A local authority
- (b) An authority constituted in India for town planning etc.
- (c) A Scientific Research Association
- (d) A university or other approved educational institution
- (e) An approved hospital
- (f) An approved Athletic Association
- (g) A registered trade union
- (h) A statutory or recognised provident fund, approved superannuation fund and an approved gratuity fund.

(i) A charitable trust

(j) A co-operative society getting dividend income from another co-operative society.

ii) Winnings from Lotteries, Cross Word Puzzles, Races, Card Games, etc.

Income from winnings in the form of lotteries, cross word puzzles, card games etc., are tax free upto Rs. 5,000 in the aggregate and the excess is chargeable. Income from horse races will be eligible for exemption upto Rs. 2,500 from the A.Y. 1992-93.

Where the total income of an assessee includes any income from the above sources, such income shall be chargeable at a flat rate of 40% plus 12% of income tax as sur charge for A.Y. 1992-93 and the balance of total income is chargeable at the normal rates applicable to the assessee.

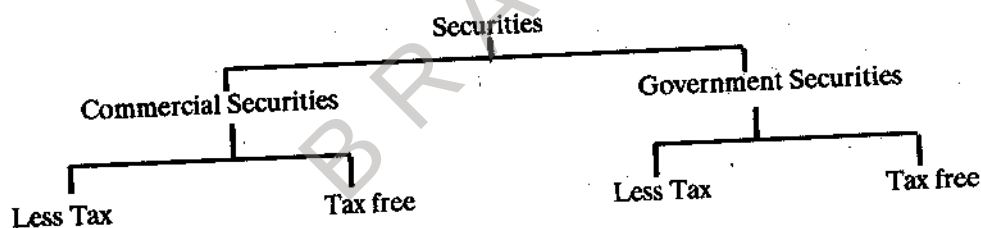
iii) Interest on Securities [Section 52 (2) (id)]

Separate head 'Interest on Securities' has been omitted with effect from Assessment Year 1989-90 and the income by way of interest on all securities is now chargeable under the head 'Income from other sources' provided it is not chargeable under 'Profits and Gains from Business or Profession.'

The term 'security' includes debentures, bonds etc., issued by Central or any State Government, local authority, statutory corporation or a company. This includes even the securities issued by a foreign government or a foreign company.

Kinds Of Securities

Kinds of Securities can be understood by way of line diagram :



(i) Commercial Less Tax Securities and Government Less Tax Securities

All Securities are less tax securities whether it is stated or not. In other words interest received in respect of all securities (unless it is specified as tax-free) is taxable and income tax is deductible at source while paying interest.

(ii) Commercial Tax Free Securities

You will agree with me that it is not possible for any one (except the Government of India) to declare any security as tax free security. At the most, the company may pay interest without deduction of tax at source and pay the tax deductible from its own pocket to the Government. This type of securities used to be issued in the past but they are not issued these days and therefore the discussion is purely academic.

(iii) Government Tax Free Securities

As has been stated above it is certainly possible for the Government to declare certain securities as tax free securities. Interest on tax free securities is treated as follows:

- (a) Interest on these securities is paid without deduction of tax at source.
- (b) Interest received on such securities is included in total income.
- (c) Rebate at the rate of 27½ percent or at average rate (whichever is less) is allowed in respect of this interest.

It may also be stated here that at present there does not appear to be any tax free Government security and, therefore, the issue is of academic nature.

Grossing Up of Interest

We have explained above that income-tax is deductible at source out of interest payable on securities unless they have been declared to be tax free securities by the Central Government. Therefore, whatever interest received by the assessee is net. However, the assessee has to include the gross amount of interest in his total income. Gross interest can be found out by adding tax deducted at source to the net interest received. The assessee receives net interest by interest warrant which is encashed through any bank. He also receives a certificate of tax deducted at source. When he adds up the two figures he gets gross interest. Grossing up rules are given hereunder:

(i) Grossing up Rules

- (a) Interest on tax free Government securities is not grossed up because there is no deduction of tax at source.
- (b) Interest on tax-free commercial securities will always be grossed up because the income-tax is payable by the company in addition to any interest payable respect of securities.
- (c) Interest on (less tax) securities will be grossed up only when the amount of interest is given on the presumption that income-tax might have already been deducted at source before paying.
- (d) Interest on the less tax securities is not grossed up if the rate of interest is given.

ii) Grossing up formula

$$\text{Gross Interest} = \text{Net Interest received} \times \frac{100}{100 - \text{Rate of tax deducted at source}}$$

Net interest received by a resident individual should be grossed up by multiplying it by the following fraction.

Security	If interest becomes due during the financial year 1991-92 or 1992-93
1. Less-Tax Government Securities	100 / 88.8
2. Debentures or other securities issued by a local authority or statutory corporation	100 / 88.8
3. Tax-free Government Securities	Grossing up not required
4. Listed debentures of a Company (whether less-tax or tax-free)	100 / 88.8
5. Less-tax non-Government securities [other than mentioned at (4)]	100 / 77.6
6. Tax-free non-Government securities [other than mentioned at (4)]	100 / 77.6

Illustration

Calculate the amount of interest to be included in total income under the head 'Income from other sources' in each of the following case:

- Abraham received Rs.900 by way of interest on tax free Government Securities.
- Shivshanker holds Rs. 20,000, 9% tax free Government Securities and he received interest thereof.
- Mohan was in receipt of Rs. 2,500 as interest in respect of securities mentioned in Section 10 (15).
- Srivastava received Rs. 2,430 as interest on convertible debentures listed in Bombay Stock Exchange.
- Sharma received Rs. 1,600 by way of interest on debentures which are not listed in any of the stock exchanges in India.

Solution

- Abraham received Rs. 900 as interest on tax free Government Securities. There is no provision of deduction of tax at source in respect of such securities. There is no question of any grossing up. The amount will be included in total income of Abraham. However, he is entitled to rebate of income-tax on Rs. 900 at the average of tax rate or at 27½ percent which ever is less.

- (b) Shivashankar will receive an amount of Rs. 1,800 as interest and it will be included in his total income. In this case also he is entitled to rebate of income-tax at average rate or at 27½ percent whichever is less.
- (c) Mohan is in receipt of Rs. 2,500 as interest on securities which are listed in Section 10(15) and therefore the interest is totally tax free. It will not be included in the total income.
- (d) Interest on debentures is taxable. Since the debentures are listed with a Stock Exchange, income-tax at source is deductible at the rate of 11.2 percent. Srivastava received Rs. 2,430 (it is supposed to be net amount after deduction of tax at source); it will be made gross by multiplying it by 100/88.8. The gross interest in this case would thus come to Rs. 2,736. An amount of Rs. 2,736 will be included in the total income of Srivastava. He will get a credit of Rs. 306 (being tax deducted at source) at the time of assessment towards the tax liability.
- (e) Sharma received interest of Rs. 1,600. It is certainly net interest after deduction of tax at source. Since the company is not listed in any of the Stock Exchange, income-tax at 22.4 percent must have been deducted at source. Rs. 1,600 will be grossed up by multiplying it by 100/77.6. The gross interest in this case comes to Rs. 2062.

Purchase and Sale of Securities

Securities can be purchased in a stock exchange. Indian securities are bought in Indian stock exchanges whereas foreign securities in stock exchanges situated in those securities. National Savings Certificates are available from the post offices whereas UNITS of the Unit Trust of India are available at the offices of the UTI.

Interest on all securities is paid on certain dates. These dates vary from company to company. Generally on debentures interest is paid twice a year. On National Savings Certificates interest is payable every six months from the date of purchase. In respect of units of the UTI, dividend is paid on 30th June each year.

Since debentures are bought and sold in the stock exchange, the buyer has to get his name entered in the register of debenture holders on buying them. The company is not aware of the buying and selling unless the transaction is registered with it.

The company pays interest due for the period to the person whose name appears in its register, without worrying whether the buyer has brought it, towards the date of interest, or has kept the securities throughout the period.

Cum-Interest and Ex-interest

Cum means 'with' and Ex-means 'without'. When we buy any security, generally we buy it with the right to receive interest on the coming due date. In other words, whatever duration in this period the seller has kept the security for that also we get interest on the due date.

The price of any security cum-interest will be more than the price of security ex-interest.

As regards computation of the taxable income under the head interest on securities, the most

important thing is the receipt of interest on the due date and not the buying and selling cum-interest or ex-interest. If you have received interest on the due date the amount will be included in your income otherwise, not.

Check Your Progress - 1

Give five items of general incomes which are chargeable to tax under this head.

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Check Your Progress - 2

List out the specified incomes under the head 'Income from other sources.'

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14.3 DEDUCTION OF TAX AT SOURCE

In earlier units we have mentioned that there are provisions in the Income-tax where the person paying various amounts are obliged to deduct income-tax at source and pay it to the Government on behalf of the person who has received that amount. For example, where the company pays salary to its employees, it will deduct income-tax at source and deposit it with the Government. A certificate to this effect will be issued by the employer company that so much tax has been deducted at source and deposited with the Government on behalf of the employee. The employee will get the credit of this amount while settling his account of income-tax at the time of his assessment.

i) Dividend

There are provisions for deduction of tax at source out of dividends also. We have stated them earlier. We may recapitulate the provisions as follows:

Income tax at source has to be deducted by the company paying dividend if the amount payable is more than Rs. 2,500.

Tax must have been deducted in respect of dividend at source during the Financial Year 1991-92 at the following rates.

i) Dividend paid to a person resident in India by a domestic company	22.4%
ii) Dividend paid to non-domestic company by a domestic company	25%
iii) Dividend paid to non-resident non-corporate assessee	30%

The shareholder will include total dividend (net amount received by him plus tax deducted at source) in his total income. It is known as gross amount. In other words it is the gross amount of dividend that is taxable and not the net amount.

Dividend received from a foreign company will be taxed in India. However, it is the net dividend that is taxable and if any tax has been deducted by the foreign company, that is not relevant here.

ii) Interest

The rate for tax deduction at source for the financial year 1991-92 is as follows:

1. Less-tax Government securities	11.2%
2. Debentures or other securities issued by a local authority or statutory corporation.	11.2%
3. Tax-free Government securities	NIL
4. Listed debentures of a company (whether less-tax or tax-free)	11.2%
5. Less-tax non-Government securities (Other than mentioned at (4))	22.4%
6. Tax-free non-Government securities other than mentioned at (4)	22.4%

iii) Winnings from Lotteries and Crossword Puzzles

During the financial year 1991-92, tax must be deducted at source at the rate 44.8 percent out of the amount payable by way of winning from lotteries, card games, cross word puzzles etc., if prize exceeds Rs. 5,000/-. In the case of winnings from horse races the exempted limit is Rs. 2,500.

14.4 DEDUCTIONS FOR EXPENDITURE INCURRED

The income chargeable under the head 'Income from other sources' shall be computed after making the following deductions namely:

From Dividend's

Any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such dividend on behalf of the assessee.

From Interest on Securities

(i) Collection Charges

Any reasonable sum spent by the assessee for collecting interest is deductible. Collection charges generally are payable to bank for effecting collecting of interest warrant/cheques etc. Whatever amount they charge is an allowable deduction.

(ii) Interest On Borrowings

Sometimes the assessee borrows money to invest it in securities. On the amount borrowed he pays interest whereas on the amount he invests in securities, he derives income. According to the provisions of Section 19(ii) interest paid on amount borrowed which has been utilised to invest in securities is a deductible expense.

(iii) In case of Income from letting of machinery, plant or furniture with or without building :

The following deductions shall be allowed from the income earned by letting of machinery, plant or furniture with or without building:

- a) Expenditure incurred on current repairs of plant, machinery, furniture or building.
- b) Insurance premium paid regarding these assets.
- c) Depreciation on plant, machinery and furniture. Depreciation in respect of buildings will be allowed only if the assessee is the owner. It will not be allowed if the assessee is lessee or mortgagee in possession of the building.

(iv) Deduction of amount deposited :

Any amount received by employer from his employees as their contribution of provident fund, E.S.I. Fund or super annuation fund is deemed as income u/s 59 (ii) if not taxable under the head "Profits and Gains from Business or Profession".

In case employer deposits any amount (out of these incomes) in these funds to the Government before prescribed due date, such amount is allowed as deduction u/s 57 (ia).

(v) Standard deduction out of family pension :

In case of income in the nature of family pension, a deduction of a sum equal to $33\frac{1}{3}\%$ of such income or Rs. 12,000, whichever is less, shall be allowed with effect from A.Y.1990-91.

Family pension means a regular monthly amount payable by employer to the legal heirs of

deceased employee.

(vi) Other Incomes

Any other expenditure incurred wholly and exclusively for the purpose of making or earning such income.

But no deduction in respect of expenditure or allowance in connection with the income by way of winning from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form, shall be allowed in computing such income. However, this restriction shall not apply in respect of the income of an assessee being the owner of horses maintained by him for running horse races from the activity of owning and maintaining such horse.

14.5 AMOUNTS NOT DEDUCTIBLE

The following amounts shall not be deducted in computing income chargeable under the head 'Income from other Sources.'

In the case of any Assessee

- (i) Any personal expenses of the assessee:
- (ia) Any expenditure in excess of Rs. 10,000 for any assessment year incurred by the assessee by way of fees or other remuneration paid to any person for services in tax matters. It does not include preparation of return of income.
- (ii) Any interest chargeable under this Act which is payable outside India and from which income-tax has not been paid or deducted at source and in respect of which there is no person in India who may be treated as agent.
- (iii) Any payment which is chargeable under the head 'Salaries' if it is payable outside India unless tax has been paid there on or deducted therefrom at source.

In the case of a Company:

Any expenditure or allowance which results directly or indirectly in the provision of any remuneration or benefit, or amenity or remuneration to a director or to a person who has substantial interest in the company or a relative of the director.

14.6 PROFITS CHARGEABLE TO TAX OR DEEMED PROFITS (SEC 59)

There are certain amounts which though not received as income are treated so under the provisions of the Act. They are incomes only by implications. They are charged to tax as incomes under Section 59. We may illustrate this point by a few examples. An assessee keeping his accounts on mercantile system gets a bill for Rs. 10,000 on account of repairs from Walchand and Sons, which he shows in the accounts. After a year when the payment is actually made, the repairer accepts Rs. 8,000 in full settlement of the bill. Thus there is a remission of Rs. 2,000. For assessment as

regards the first year an expenditure of Rs. 10,000 will be accepted by the Assessing Officer but in the second year Rs. 2,000 being remission will be taken to be the income taxable under the head 'Income from other sources'. The following are incomes taxable under this section:

- i) Under-payment of allowed expenditure.
- ii) Recovery of loss.
- iii) Remission on cessation of trading liability.
- iv) Balancing charge in respect of assets, the income of which is chargeable under this head.

14.7 COMPUTATION OF INCOME FROM OTHER SOURCES

To summarise, the income from other sources is to be computed as follows:

I. Items to be included (Sec. 56)

1.	Dividends	...	
2.	Any annuity due or commuted value of any annuity to be paid under Sec.280D	...	
3.	Income from winnings from lotteries, card games, betting, etc	...	
4.	Sums received from employees as contributions to PF or other funds	...	
5.	Income by way of interest on securities	...	
6.	Hiring of machinery, plant, buildings, etc., meant for own business	...	
7.	Deemed profits (Sec. 59)	...	
8.	other items	...	...

II. Less Deductions (Sec. 57)

1.	Collection charges for dividends or interest on securities	...	
2.	Repairs insurance, depreciation etc., in case of own business assets hired out	...	
3.	Other incidental expenses	...	...
	Income from other sources	...	...

Check Your Progress - 3

From the following particulars, compute Mr. Rao's Income from other sources for the Assessment year 1992-93

- i) Mr. Rao is the author of a text-book, which fetched him a gross royalty of Rs. 20,000. He claims the following deductions in this regard:
 - a) Salary to a clerk who collects necessary data Rs. 1,000.
 - b) He purchased books worth Rs. 1,000 in connection with the revision of the text book.
- ii) Income from articles published in journals Rs. 1,000.
- iii) His other incomes are:
 - a) Winnings from card games Rs. 6,000.
 - b) Interest on bank deposits received Rs. 1,000.
 - c) Equity dividend Rs. 500.
 - d) Income received by sub-letting a house which he has taken for Rs. 200 p.m. Rs. 400 p.m.

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14.8 ILLUSTRATIONS

Mr. Rami Reddy gives you the following particulars in respect of the previous Year 1991-92.

Director's fees Rs. 5,000 ; income from agricultural land in Ceylon Rs. 10,000, ground rent Rs. 2,000; interest on post office savings bank account Rs. 2,500; interest on fixed deposit with Industrial Development Bank of India, 7,500; rent received by sub-letting, Rs. 14,000; dividends from foreign companies, Rs. 3,450 ; winnings from horse races Rs. 25,000.

You are required to compute total income under the head 'Income from other Sources'

Solution

Income from other Sources

	Rs.
(a) Director's fees	5,000
(b) Income from agricultural land in Ceylon	10,000
(c) Ground Rent	2,000
(d) Interest of Fixed deposit in IDBI	7,500
(e) Income from sub-letting	14,000
(f) Dividends from foreign companies	3,450
(g) Winnings from house races (25,000-2,500)	22,500
Total income under the head 'Income from other source'	<u>64,450</u>

Notes

1. Interest on Post office savings bank account is totally tax free and therefore, not included in total income.
2. Winnings from horse race is casual income to the extent of Rs. 2,500/- and only the excess amount is taxable.
2. Mr. Harsha Sathe is employed with Winners Ltd. as General manager on a monthly salary of Rs. 5,000, plus dearness allowance amounting to Rs. 1,000 per month. His other incomes are as under:

	Rs.
(a) Interest of Fixed Deposits in Companies	10,000
(b) Examination remuneration from Universities	7,500
(c) First Prize in Andhra Lotteries	1,00,000
(d) Casual Income	5,000
(e) Royalty received in respect of a book on Secretarial Practice. He claims expenditure of Rs. 10,000 which he incurred in writing this book	45,000
(f) Dividends of Rs. 35 per share in Century Limited	3,500

(g)	Interest on post Office Savings Bank account	3,250
-----	--	-------

His bankers charged Rs. 100 for collecting various amounts during the course of the year. You are required to compute gross total income.

Solution

	Rs.	Rs.	
Salary Income			
Salary		60,000	
Dearness Allowance		12,000	
		<u>72,000</u>	
Standard deduction		12,000	
Net Salary		<u>60,000</u>	
Income from other source			
Interest on fixed deposits in companies		10,000	
Examination remuneration		7,500	
Lottery Winnings		1,00,000	
Casual Income (5,000-5,000)		—	
Royalty received	45,000		
Less Expenses incurred	<u>10,000</u>	35,000	
Dividends		<u>3,500</u>	
		1,56,000	
Less Bank charges		<u>100</u>	1,55,900
Gross Total Income			<u>2,15,900</u>

Note: Interest on Post office Savings Bank Account is totally exempted and therefore, it has not been included in total income.

3.X a resident individual, submits the following particulars of his income for the previous year ending March 31, 1992.

Dividend from XYZ Ltd. (gross): Rs. 4,600; dividend from ABC LTD. (net) Rs. 2,800; interest paid on capital borrowed for the purpose of investment is shares of XYZ Ltd. Rs. 3,400; collection charges in respect of dividend: Rs. 260.

Rent from letting a building along with plant and machinery (rent of building cannot be separated from rent of plant and machinery) Rs. 30,600. Fire insurance premium in respect of building: Rs. 600. Fire insurance premium in respect of plant and machinery: Rs. 750. Repairs in respect of building: Rs. 4,600. Depreciation on building, plant and machinery: Rs. 18,600.

Winnings from lottery : net amount : Rs. 60,000 : tax deducted at source Rs. 40,000.

Winning from card games : Rs. 13,500.

Interest on securities of A.P. Govt. Rs. 4,800 of which collection charges are Rs. 100.

Determine the income chargeable under the head "Income from other sources" for the Assessment Year 1992-93.

Solution

COMPUTATION OF INCOME UNDER THE HEAD "INCOME FROM OTHER SOURCES"

	Rs.	Rs.	Rs.
Dividends			
from XYZ	4,600		
from ABC Ltd.			
(i.e. Rs. 2,800 + 100/77.6)	<u>3,608</u>	8,208	
Less : Expenses:			
Interest	3,400		
Collection charges	<u>260</u>	<u>3,660</u>	
Income from dividend			4,548
Rent received		30,600	
Insurance (i.e., Rs. (600 + 750))	1,350		
Repairs	4,600		
Depreciation	<u>18,600</u>	<u>24,550</u>	
Income from letting			6,050
Winnings from lottery:			
Net amount	60,000		

Add : Tax deducted at source	40,000	1,00,000	
Winning from card games	13,500		
Less : Exempt under section 10 (3)	5,000	8,500	1,08,500
Interest on securities of A.P. government		4,800	
Less : Collection charges		100	4,700
Income from other sources			1,23,798

4. Mr. Sudheer holds the following securities on April, 1 1991.

Rs.3,00,000 5% tax-free A.P. Government loan (date of payment of interest : January 1).

Rs. 40,000 6% Non-listed debentures of XYZ Ltd. (dates of payment of interest: June 11 and December 11 every year)

Rs. 25,000 8% debentures of ABC Ltd. (dates of payment of interest : June 15 and December 15 every year)

On December 1, 1991 Sudheer sells Rs. 25,000 8% debentures of ABC Ltd. His income from the heads 'salaries' and 'House Property' is Rs. 10,000 and Rs. 5,000 respectively. Calculate the Gross total income of Sudheer for the assessment year 1992-93 on the assumption that his business income is Rs. 64,000.

Solution:

Tax free A.P. Government loan (Rs. 3,00,000 $\times$ 5/100)	15,000
Debentures of XYZ Ltd.	2,400
Debentures of ABC Ltd. (Interest accrued on June 15, 1991 (Rs. 25,000 $\times$ 8/100 $\times$ 1/2))	1,000
Interest on securities taxable under the head "Income from other sources".	18,400
Salary income	10,000
House Property Income	5,000
Business income	64,000
Gross Total Income	97,400

14.9 SUMMING UP

The last head concerns 'Income from Other Sources'. All those incomes which could not be considered under the earlier heads, find place under this all-pervasive head. Casual incomes, dividends, winnings from lotteries, interest on securities, crossword puzzles, etc. are some of the incomes taxable under this head.

14.10 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Income from royalties ii) Income from sub-letting iii) Interest on bank deposits iv) income from letting out of cinema theatres v) Agricultural income received from out side India.
2. i) Dividends ii) Any winning from lotteries, crossword puzzles, races, card games, horse races, iii) Interest on securities, iv) income from letting on hire any machinery, plant or furniture belonging to the assessee, if it is not chargeable to tax under the head 'profits and gains from business or profession'. v) Income from letting on hire any building in which plant and machinery is situated and letting of building is inseparable from that of plant and machinery.
3. Computation of Income from other sources of Mr. Rao for the A.Y. 1992-93

i) Royalty		20,000	
(-) Expenses :			
Salary	1,000		
Books	1,000	2,000	18,000
			1,000
ii) Income from writing articles			
iii) a) Winning from card games		6,000	
(-) exempted u/s 10(3)		5,000	1,000
b) Interest on bank deposit			1,000
c) Equity dividend			500
d) Sub-letting:			
Rent received		4,800	
Rent paid		2,400	2,400
			23,900
Income from other sources			

14.11 MODEL EXAMINATIONS QUESTIONS

I. Essay Questions

Answer the following in about 30 lines each:

1. Discuss the scope of the last head of income, namely, 'Income from other Sources' and state the deductions allowable.
2. Define 'dividend' and explain the term fully.
3. Explain the chargeability under the head 'Income from Other Sources' with fifteen examples of incomes that are taxable under this head.
4. Compute total income of Mr. Rajesh from the particulars supplied by him:
 - (a) Salary at Rs. 3,000 per month.
 - (b) Dearness allowance at Rs. 500 per month.
 - (c) Dividends Rs. 10,000 (gross amount) from Reliance Ltd.
 - (d) Interest on fixed deposit of State Bank of India Rs. 5,000.
 - (e) Hire charges of Plant and Machinery, Rs. 25,000.
 - (f) Depreciation of Plant and Machinery, Rs. 5,000.
 - (g) Insurance premium paid in respect of Plant and Machinery, Rs. 500.

II Short Questions

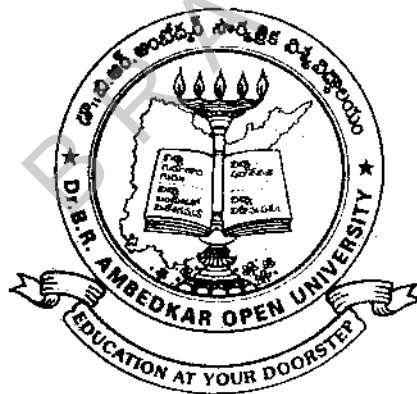
Answer the following in about 15 lines each :

1. Discuss the chargeability of the head 'Income from other sources'.
2. When is distribution on liquidation of companies treated as dividend?
3. Give ten examples of incomes that are taxable under the head 'Income from other sources'.
4. Discuss the amounts that are not deductible under the head 'income from other sources'.
5. Explain what deductions are allowable under the last head of income.
6. What are the different kinds of securities?
7. Explain the items taxable under the last head as deemed profits chargeable to tax.
8. Explain the provisions regarding deduction of tax at source out of winnings from crossword puzzles.
9. What is grossing up of interest?

BRAOU

INCOME TAX

- BLOCK IV** - **AGGREGATION AND DEDUCTIONS**
BLOCK V - **COMPUTATION OF TOTAL INCOME AND TAX**
BLOCK VI - **ASSESSMENT**



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The provisions stated in these units are applicable to the Assessment year 1992-93.

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PREFACE

This book deals with the topics in Income-tax included in the syllabus for the third year of the B.Com., course offered by the Dr. B.R. Ambedkar Open University. These topics generally cover the 'core' area of the subject to be studied in the Third year of the Three Year Degree Course in Commerce (B.Com.). The syllabus for the sake of convenience is divided into blocks, each of which comprises a number of units. Each unit generally covers a specific area of the subject. The units are prepared by specialist in accordance with format so designed as to enable the student to read and understand them without much difficulty. Each unit begins with a statement of its objectives followed by a synopsis and has at its end assignment intended to test the student's comprehension of its subject matter.

This material has been updated keeping in view the provision of the Finance Act, 1992. The study of this material would be useful both for the students and the professionals. The illustrations have been explained in a lucid way with necessary notes wherever necessary. In the light of the practical importance of the knowledge of Income-Tax to the students of commerce. Income-Tax is offered as one of the optional course of B.Com. Third year programme.

The course material of Income-Tax consists of 6 blocks, which have been divided into 26 units. The first block deals with the concepts of Income-Tax. The second block covers exemptions. Block III discusses the various heads of income. Block IV deals with Aggregation and Deductions from Income. Block V presents computation of Total Income and tax. Block VI covers Income-Tax Authorities and assessment procedure.

The University hopes that this material will help the student to get acquainted with the principal issues in income-tax which make for its distinctiveness and significance.

BRAOU

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BLOCK - IV

AGGREGATION AND DEDUCTIONS

This Block deals with Aggregation of Income and Deductions allowed from Gross Total Income. It includes four units : They are :

- | | | |
|-----------|---|---|
| Unit - 15 | : | Clubbing of Income |
| Unit - 16 | : | Set off and Carry Forward of Losses |
| Unit - 17 | : | Deductions from Gross Total Income - I |
| Unit - 18 | : | Deductions from Gross Total Income - II |

BRAOU

UNIT - 15: CLUBBING OF INCOME

Contents

- 15.0 Aims and objectives
- 15.1 Introduction
- 15.2 Transfer of Income
- 15.3 Revocable Transfer of Assets
- 15.4 Income to Spouse from the Firm
- 15.5 Commission, Salary, etc. of Spouse
- 15.6 Income to Minor Child from a Firm
- 15.7 Income to Spouse from the Assets Transferred
- 15.8 Income to Minor-Child from the Assets Transferred
- 15.9 Assets Transferred to Son's Wife and Son's Minor Child
- 15.10 Income to a Person from the Assets Transferred
- 15.11 Assets Transferred to Association of Persons
- 15.12 Transfer of Individual's Property to Hindu Undivided Family
- 15.13 Summing Up
- 15.14 Check Your Progress: Model Answers
- 15.15 Model Examination Questions

15.0 AIMS AND OBJECTIVES

The objective of this unit is to explain you the provisions in the Income-Tax Act, which are designed to prevent transfers intending to reduce the tax liability.

After completing this unit, you should be able to:

- * explain the clubbing provisions in case of income to spouse from the firm and any salary, commission or remuneration received by a spouse.
- * explain the clubbing provisions in case of income received by a minor child from a firm.
- * discuss the provision relating to income from assets transferred to the spouse, minor child, son's minor child or son's wife.
- * discuss the clubbing provisions when assets are transferred to association of persons and individual's property is transferred to Hindu Undivided Family (HUF)
- * advice persons whether the transfer of amounts to their near relatives is beneficial from the tax angle or not.

15.1 INTRODUCTION

Income-tax rates are progressive in the sense that the higher the income the higher the rates. The total income that is arrived at after allowing all the available deductions is broken into slabs and each successive slab is taxed at an increasing rate. For example, the total income of an assessee X is Rs 1,00,000. It is broken into, say five slabs of Rs.20,000 each. We may exempt the first slab, saying that it is a no-tax slab, whereas the second, third, fourth and fifth slabs may be taxed at 30,35,40 and 50 percent respectively. You have, thus, seen that the taxpayer pays income-tax at rate which goes on increasing with every successive slab.

In order to reduce one's tax liability there is a possibility that the assessee might try to transfer certain income-yielding assets or incomes to his dear ones and thus split his income over a few heads which will ultimately reduce his tax liability. You might have seen persons transferring amounts to their wives thinking that by this method, interest accruing on these amounts will not be taxable. Thus, they reduce their tax liability.

The provisions in the Income-Tax Act have been designed in such a way to prevent transfers which are effected with a view to reducing the tax liability. In other words, when apparently the income accrues to others, it is included in the total income of the assessee. It is known as clubbing of income. These provisions are made to prevent the assesses from indulging in such type of activities with a view to reducing the tax liability. In this unit we will study all those provisions.

15.2 TRANSFER OF INCOME (Section 60)

You may think of a situation where the assessee keeps ownership of his house with him but transfers the income accruing therefrom to his relative A. In this case the asset has not been transferred but income flowing therefrom goes to his relative. Here the income which apparently goes to his relative will be taxed in the hands of the assessee and not the relative. Transfer for the purpose of this section includes any settlement, trust, covenant, agreement or arrangement.

15.3 REVOCABLE TRANSFER OF ASSETS (Section 61)

The term 'revoke' means 'to recall', 'call back', to 'withdraw'. A transfer where the transferor keeps with himself the right to withdraw or call back the transfer is known as revocable transfer. For example, assessee X transfers his house to his son but while transferring he makes it clear that he will be free to revoke the transfer any time he likes. This transfer is known as revocable transfer.

Where the asset is transferred by the assessee and the transfer is a revocable transfer, income from the asset will be taxable in the hands of the transferor and not the transferee.

However, if there is a condition that the transfer will not be revocable during the life time of the transferor or the transferee, the transfer will not be treated as a revocable transfer and therefore the income flowing from the transferred will be taxed in the hands of the transferee.

The transfer will also be known as a revocable transfer if the transferor derives direct or indirect benefit from such income.

15.4 INCOME TO SPOUSE FROM THE FIRM (Section 64 (1) (i))

It is common knowledge that in many firms both husband and wife happen to be partners. There are many situations where the wife takes active interest with her husband in a business or

profession. There are firms with only lady partners; there are firms with two or three male partners and one or two female partners. There are dispensaries where both husband and wife are doctors. Section 64 (1) (i) takes care of one of such situation.

Where both husband and wife are partners in a firm engaged in business, income from such firm, accruing to both of them shall be included and taxed in the hands of one person only. It will be added in the total income of one whose income from all other sources is higher than the total income of the other spouse. For example, X and his wife XW are partners in a firm with three other partners sharing profits and losses equally. The firm earns a profit of Rs.2,00,000 and there of X and XW get Rs.40,000 each. X derives total income from all other sources of an amount of Rs.80,000 whereas XW's income from all other sources is Rs.50,000. In this case XW's share of profit from the partnership firm amounting to Rs.40,000 will be included in the total income of X. He will, therefore, pay tax on the following incomes:

Income from all other sources	Rs.	80,000
His share of profit from the firm	Rs.	40,000
Share of profit from the firm to his wife	Rs.	40,000
Total		<u>1,60,000</u>

His wife XW will pay tax only on her income of Rs.50,000 which she derives from other sources.

However, this provision is not applicable in respect of professional firm or where an individual in a partnership firm represents his HUF as its karta and his share of income from the firm goes HUF.

Further, for the purpose of Sec.64 (1) (i), the relation of husband and wife must subsist at the time of accrual of income. Death or divorce in the middle of the previous year leads to cessation of the above relationship and the clubbing provision cannot be applied.

Note: W.e.f. the A.Y. 1993-94, the above clause (i) shall be omitted in view of the new scheme of taxation of firms.

15.5 COMMISSION, SALARY, ETC. OF SPOUSE (Section 64 (1) (ii))

You are aware that partners in the firm draw remuneration in a number of ways. They are entitled to salary, commission etc., for the work done and the active interest taken in the running of the firm. Similarly, You might have seen some companies where wives of a few influential shareholders are employed on flat salaries and are also allowed commission on sale etc. This is nothing but the transfer of income where husband shareholders are interested in transferring incomes to their wives.

Any payment by way of salary, commission, fees or any form of remuneration whether in cash or in kind received by the spouses from a concern in which such individual has substantial interest will be added to the total income of the individual. However, this rule will not apply if the income is derived by the spouse from the concern on account of his/her technical or professional qualifications having been applied in the discharge of duties.

15.6 INCOME OF MINOR CHILD FROM A FIRM (Section 64 (1)(iii))

You might have seen many persons having their minor children, as partners with them in firms doing business. In most of these cases, minor children are made partners or substantial shareholders in companies from the tax angle. Sometimes these children inherit property from their ancestors and with the help of this ancestral property they are made partners.

The Income-Tax Act does not allow tax benefits in such cases. Accordingly income arising to minor child from his admission to the partnership firm will be added to the income of his parent. It is not necessary that the parent must also be a partner in the firm. It is also interesting to learn that a minor can be admitted to a partnership firm for benefit only. He will not share the losses, if any, arising to the firm. The provision will hold good in all cases and it is not relevant whether the minor has contributed his own capital or has taken the capital from his parents. In all cases where the minor is deriving income from his membership of the firm it will be added to the income of the parent.

Now the question arises as to which of the parents such income will be added. The answer is, whose income is greater. For example, minor X derives Rs.45,000 as income from his membership of the firm Goodluck and company. His father XF has a total income amounting to Rs.80,000 whereas his mother XM earns Rs.65,000 from her medical profession. In this case X's income of Rs.45,000 will be added to the income of his father because, his income is greater. Thus father XF will pay income-tax on Rs.1,25,000 whereas his mother XM on Rs.65,000 being her income from the profession.

Note: W.e.f.the A.Y.1993-94 the above clause (iii) shall be omitted in view of insertion of new sub-section (1A).

15.7 INCOME TO SPOUSE FROM THE ASSETS TRANSFERRED (Section.64 (1) (iv))

We are aware that there are many persons who transfer their own properties to their wives. Similarly there may be cases where the wife has transferred some of her assets to her husband. Sometimes, these transfers are out of love and affection whereas at other times the transfer is prompted by tax considerations. Income-Tax Act does not differentiate between the two. For admission of law, transfer to a spouse is a transfer, whether it be with a view to reducing tax liability or not.

Any income accruing to the spouse from the assets other than house property transferred directly or indirectly by the individual will be included in his total income under the above section. Such inclusion will not hold good if the transfer of assets is for adequate consideration. In other words, if there is a transfer on account of sale then income from such asset should not be included in the income of the assessee. For example, husband X sells his debentures to his wife XW for a consideration of Rs.2,50,000 which is a fair market value. In this case the interest on debentures will be taxed in the hands of XW only. Similarly if the transfer of asset is in view of an agreement to live apart, income from the transferred asset will be taxed in the hands of the transferee only.

Check Your Progress-1

Explain the clubbing provision relating to the income of spouse.

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.....

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15.8 INCOME TO THE MINOR CHILD FROM THE ASSETS TRANSFERRED (Sec.64 (1)(v))

There are provisions in the Income-Tax Act to prevent transfers of assets to minor children because this type of transactions reduces tax liability considerably.

Where an individual transfers assets (other than house property) to his/her minor child, without adequate consideration, the income accrues from the transferred asset will be taxed in the hands of the transferor and not the child. For example X gifted shares worth Rs.20,000 to his minor daughter Y. The dividend earned by Y on these shares is taxable in the hands of X, only but not Y.

Note: W.e.f. the A.Y. 1993-94 the above clause (v) shall be omitted in view of insertion of new sub-section (1A)

15.9 ASSETSTRANSFERRED TO SON'SWIFE OR SON'S MINOR CHILD (Section 64 (i)(vi))

You might have seen grand parents transferring assets to their grand children. Similarly, sometimes persons transfer their assets to their daughters-in-law. The section cited above takes care of such transfers.

Income from the assets transferred to a son's wife or son's minor child will be the subject matter of tax in the hands of the transfer. This section will apply only when the transfer has been made for no consideration or inadequate consideration. Where the assets transferred for adequate consideration such clubbing will not operate. Similarly, assets transferred to a daughter's minor child will be outside the scope of this section.

Note : W.e.f. the A.Y. 1993-94, the term "son's minor child" shall be omitted in view of insertion of new sub-section (1A).

15.10 INCOME TO A PERSON FROM THE ASSETS TRANSFERRED (Section 64 (1) (vii))

This section covers a wide variety of situations when assets are transferred to a person or association of persons otherwise than for adequate consideration . Under the above section income accruing to any person or association of persons from assets transferred directly or indirectly will be taxed in the hands of transferor if the following conditions are complied with.

- a) The transfer is either for no consideration or inadequate consideration.
- b) The income from the assets benefits his or her spouse or minor child or both.

Note: W.e.f. the A.Y. 1993-94 the term 'Minor Child' shall be omitted in view of insertion of new sub-section (1A).

Check Your Progress -2

List out provisions relating to income arising to minor child.

.....

.....

.....

Check Your Progress -3

How do you treat the incomes arising from the assets transferred?

15.11 ASSETS TRANSFERRED TO ASSOCIATION OF PERSONS (Section 64 (1) (viii))

Any income arising directly or indirectly to person or association of persons from assets transferred shall be included in the income of the individual. Other conditions necessary for clubbing under this clause are as follows :

- a) The transfer to such a person or association of persons shall be otherwise than for adequate consideration.
- b) It will be clubbed only when and to the extent to which the income from such assets is for the immediate or differed benefit of his son's wife or son's minor child or both.

Note: W.e.f. the A.Y. 1993-94, the term " son's Minor child" shall be omitted in view of insertion of new sub-section (1A) .

Note: The following new sub-section (1A) will come into force w.e.f. the A.Y 1993-94.

In computing the total income of any individual, there shall be included all such income as arises or accrues to his minor child provided that such income shall not arises or accrues on account any manual work done by him, or actively involving application of his skill, talent or specialised knowledge and experience.

15.12 TRANSFER OF INDIVIDUAL'S PROPERTY TO HINDU UNDIVIDED FAMILY (Section 64(2))

You may have come across hindu families which in the language of income-tax are known as Hindu undivided families (HUFs) . We will now discuss the clubbing provisions when assets are transferred to the HUFs by an individual who is a member thereof.

Where an individual who is a member of HUF transfers his self-acquired property to the family such transfer will be dealt with as follows:

- a) The individual shall be deemed to have transferred the property through the family to the members of the family for being held by them jointly.
- b) The income derived from the converted property or any part thereof shall be deemed to arise to the individual and not to the family.
- c) Where the converted property has been the subject matter of a partition amongst the members of the family, the income derived from such converted property as is received by the spouse or minor child on partition shall be deemed to arise to them from assets transferred by the individual to the spouse or minor child, and the provisions of section 64 (1) shall apply

Note: The words "minor child" shall be omitted in the above subsection w.e.f. the A.Y. 1993-94.

Illustration

Vijaya kumar is a member of a Hindu Undivided Family . He transfers a sum of Rs.1,00,000 from his bank account to the HUF . It brings in an annual interest of Rs.12,000. The HUF consists of himself and his minor son. In this case, in view of Section 64 (2) it will be assumed that the whole of Rs.12,000 accrue to Mr.Vijaya Kumar and there is a deeming provision that he wants to transfer Rs.4,000 to his wife and Rs.4,000 to his minor son through the HUF. The whole amount of Rs.12,000 will be taxed in his hands.

15.13 SUMMING UP

This unit is concerned with the clubbing of income. These provisions have been given in the Income Tax Act,1961, with a view to preventing assesseees from transferring their sources of incomes or incomes to their near relatives for reducing their tax liability.

Where someone transfers his property sources of income to his/his spouse, minor children etc, income from the transferred property is added to the income of the transferor. These provisions are applicable even to the assets transferred to grand children and daughter-in-law etc.

15.14 CHECK YOUR PROGRESS: MODEL ANSWERS

1. i) Income of spouse from a firm in which both husband and wife are partners, is added in the income of that spouse whose other income is higher.
ii) Any salary, commission etc, received by a spouse from concern in which individual has substantial interest is added in the income of such individual.
iii) Income from any asset transferred to the spouse without adequate consideration shall be included in the income of transferor.
2. i) Any share of income received from a firm by a minor, who is admitted to the benefits of partnership is added in the income of that parent whose other income is higher.
ii) Income from an asset transferred to minor child without adequate consideration shall be included in the transferor's income.
3. i) Income from any asset transferred to the spouse , minor child, son's minor child or son's wife, without adequate consideration is included in the income of transferor.
ii) Income from an asset transferred in such a way that benefit from it is still accruing to transferor or his spouse or minor child, is added to the income of transferor.

15.15 MODEL EXAMINATION QUESTIONS

I Essay Questions

Answer the following questions in about 30 lines each

1. "An assessee is not only liable in respect of his own income but his liability to tax extends to some other's income also" Explain.
2. Discuss the circumstances under which a minor's income is liable to be included in the income of his father, giving reasons thereof.

II Short Questions

Answer the following questions in about 15 lines each

1. Under what circumstances is income of a minor includible in the income of his father?
2. When is income arising to wife included in the income of her husband?
3. Give five examples when clubbing provisions will operate.
4. How do you treat self earned assets being transferred to the HUF?
5. Explain the clubbing provisions.
6. How do you treat income from assets transferred revocably?

BRAOU

UNIT - 16: SET OFF AND CARRY FORWARD OF LOSSES

Contents

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- 16.3 Set off of Losses
- 16.4 Illustrations
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- 16.8 Summing Up
- 16.9 Check Your Progress: Model Answers
- 16.10 Model Examination Questions

16.0 AIMS AND OBJECTIVES

The objectives of this unit are to discuss the grouping of all incomes and losses; and carrying forward the loss to the following years for set off.

After going through this unit, you will be in a position to:

- * explain aggregation of Income,
- * discuss the set off losses,
- * describe the provisions of carry forward and set off of losses.

16.1 INTRODUCTION

We have explained the technique of computation of income under different heads numbering five in all. We have not yet discussed a position where one or more of the heads yield negative income, that is loss. There is a possibility of getting a negative income (loss) while computing taxable income under a given head. For example, where the permissible deduction exceed income under that head, the result is bound to be a loss. Taking the case of business or profession, it is quite normal to here that such and such business has incurred so much loss. However, you might not have heard that income from house property is yielding a negative figure. It is also possible when the permissible deductions exceed the annual value of house property. The net result of computation will be loss. Generally you have seen persons constructing their houses with borrowed money. This type of arrangement involves heavy payment of interest and therefore, total permissible deductions exceed annual value.

While computing taxable income under various heads, certain heads yield profit whereas certain other might show losses. In that case all such amounts are to be aggregated to find out the net result.

In case loss exceeds profit, the net result will end up in loss, while it will result in profit if gains under different heads exceed negative incomes under some other heads. Thus, the losses are made good by profits and the net result found out. The process of meeting losses by profits is known as set off of losses. In case total losses to be set off are more than the profit available, the result of computation will be net loss.

16.2 AGGREGATION OF INCOME

Aggregation of income is the subject matter of section 66. It says that taxable income computed under different heads is to be aggregated and the resultant figure is known as Gross Total Income. You will remember one that the gross total income includes taxable income, and deemed income and rebatable income.

(i) Rebatable Incomes

Rebatable incomes are included in the total income of the assessee only for the sake of determining the rate of taxation.

The rebatable income is included in total income first and then rebate at average rate is allowed thereon. For example, there is total income of Rs.50,000 which includes rebatable income of Rs.10,000. In this case income-tax on Rs.50,000 will be worked out and then rebate of income-tax on Rs.10,000 at average rate calculated. Income-tax worked out minus rebate so calculated will be the tax payable. We may do it as below:

	Rs.
Income-tax on Rs.50,000	7,600
Average rate $7,600 / 50,000 \times 100 = 15.2$ percent	
Rebate on Rs.10,000 at 15.2 percent	1,520

Tax payable	6,080

Following are the rebatable incomes included in total income of the assessee:

- Assessee's share in the profits of an unregistered firm on which income-tax has been paid by the firm.
- Amount of profit received or receivable from the association of persons or a body of individuals where tax has been paid by such association or body of individuals.
- Interest on tax-free Government securities is included and then rebate of income-tax at average rate or at $27\frac{1}{2}$ percent (whichever is less) is allowed thereon.

Other Incomes

Under this head we will include those amounts which do not come within the scope of assessee's total income, but cannot be excluded:

(i) Partner's Share

Interest on capital, salary, commission etc. received by the partner are not admissible expenses. They are added back to profits. The firm has to pay income-tax on its income without deduction of these items. The profit so arrived at is divided amongst the partners and they pay tax thereon.

Note: This provision shall be omitted W.e.f the A.Y. 1993-94.

(ii) Cash Credit

The amount of unexplained cash credits found credited to the accounts of the assessee is included in the total income of that previous year.

(iii) Unexplained Investment

The amount of investments not recorded in the books of accounts and for which proper explanation is not offered by the assessee is added to his total income and is deemed to be the total income of the assessee for that previous year.

(iv) Unexplained Money, etc

If the assessee is found to be the owner of any unrecorded money, bullion, jewellery or other valuable articles and in case the source of income is not properly explained by him, the amount of these is added to total income for that financial year.

(v) Investment, Bullions, etc. not Fully Explained

Section 69B provides for the inclusion of the excess expenditure in respect of investment, bullions, jewellery etc., over the amount recorded in the book. The excess amount may be deemed to be the income of the assessee for that financial year.

(vi) Unexplained Expenditure, etc.

Where in any financial year, an assessee has incurred any expenditure and he does not offer any explanation about the source of such expenditure or part thereof the explanation offered by him is not found satisfactory by the AO, the amount covered by such expenditure etc. may be deemed to be the income of the assessee for that financial year.

(vii) Amount Borrowed or Repaid on Hundi

You might have come across transactions in business where businessmen borrow amounts on Hundi. Hundi is an Indian or rather indigenous form of Bill of Exchange. Such instruments are used often in business and industry. The Income-tax law has made it obligatory that all transactions in Hundies should be through an account payee cheque drawn on a bank. Where any amount is borrowed or repaid through any other mode of payment, such amount will be deemed to be the income of the assessee of the previous year in which such payment has been made.

16.3 SET OFF OF LOSSES

We have explained above that taxable income from various heads has to be lumped and then gross total income found out. While lumping natural losses from some heads, if any have to be set off against income from other heads, this process is known as set off losses against incomes. Though the whole process is easy, there are certain rules which have to be complied with while computing gross total income after set off of losses. They are discussed below.

(i) Loss of One Source Against income from another Source Under the same Head of Income: Section 70

Source is smaller in scope than the head. One head of income can have any sources. For example, under the head business and profession, the assessee might have many businesses.

Similarly, while computing income under the head house property, the assessee may have more than one house. In all such cases first of all the assessee is required to compute taxable income under various sources of income and then the sources are grouped headwise.

Loss from one source of income can be set-off against profit from another source of income under the same head. For example, loss from house property 'A' can be set off against the profit from another house 'B'. This rule is subject to the following two exceptions:

- (i) Loss from speculation can be set-off only against the profit from speculation whereas profit from speculation can be utilised in setting off losses from other business sources.
- (ii) Loss from the business of owning and maintaining race horses cannot be set-off against any other income under the same head.

(iii) Loss From One Head against Income from another: (Section 71)

Loss from one head of income can be set off against income from another head, such loss may also be set off against capital gains-both short term and long term. However, loss from Capital assets (whether short term or long term) cannot be set off against income from any other head.

Further long-term capital loss is to be scaled down as per Section 48(3) and then it is to be set off against income under the same head.

Note: A new sub-section (4) will come into force W.e.f the A.Y. 1993-94, providing for as follows:

Loss from let out house property shall not be set off against the income under any other head [other than property covered by Section 23 (2) (a) (i)]

(iii) Loss from Speculation Business (Section 73 (i))

Loss from speculation can be set off against profits from speculation only. On the other hand profit from speculation can be used for wiping out the losses from other business.

It has been explained that the business of purchase and sale of shares by companies, which are not investment, banking or finance companies, is to be treated as speculation business. The result is that losses from such dealing will be set-off only against from similar dealings in shares.

(iv) Losses in business of owning and maintaining race horses (Section 74A).

Where the net result of computation under "income from the other sources" in respect of the activity of owning and maintaining of race horses is a loss, such loss cannot be set off against any other income under the same head or against income under any other head.

Check Your Progress - 1

How do you set off Speculation loss?

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Check Your Progress - 2

Explain in brief the set off provision of loss from one head against income from another head.

16.4 ILLUSTRATIONS

1. The following particulars are supplied by Mr. Ranga Rao for computation of total income for the assessment year 1992-93.

		Rs.
Salary (Taxable amount)		35,000
Income from house property A		10,500
Loss from house property D		13,000
Loss from registered firm		20,000
Profit from speculation business		56,000
Long-term Capital gains		35,000
Long term Capital loss		10,000
Interest on securities		12,400
Solution		Rs.
Salary		35,000
Income from house property:		
Income from property A	10,500	
Loss from Property D	<u>13,000</u>	(-) 2,500
Profit and gains of Business or Profession:		
Profit from speculation	56,000	
Loss from registered firm	<u>-20,000</u>	36,000
Capital Gains:		
Long term capital gains:	35,000	
Less: deduction u/s 48		
First Rs.15,000 - 100%	Rs.15,000	
50% of the balance (i.e., 35,000 - 15,000)	<u>Rs.10,000</u>	25,000
		10,000

Long term capital Loss	10,000	
Less: Deduction u/s 48		
First Rs.15,000 - 100%	<u>10,000</u>	Nil
Income from other sources:		
Interest on securities		12,400
Gross Total Income		90,900

2. Sri Ahsan Ahmed submits you the following particulars of his income and losses for assessment year 1992-93 and you are required to compute his gross total income for the same:

		Rs.
Salary from Goodluck Ltd. (taxable)		45,000
Profit from Agency business		34,000
Loss from cloth business		10,000
Loss from short-term capital assets		10,000
Loss from speculation in silver		56,000
Winning from Lottery		50,000
Casual Gains		5,000
Interest on securities (gross)		10,000
Solution		Rs.
Salary		45,000
Profit from agency busines	34,000	
Loss from cloth business	<u>10,000</u>	24,000
Loss from Short-term assets		10,000
Income from other sources:		
Casual gains	5,000	
Winnings from lottery	50,000	
Interest on securities	<u>10,000</u>	
	65,000	
Less exempted amount	<u>5,000</u>	60,000
Grand Total Income		1,19,000

Note: Loss from speculation can be set off against profit from speculation business. Since there is no speculation profit in this case, loss from speculation can not be set off. It will be carried forward to the next year for set off.

16.5 CARRY FORWARD AND SET OFF OF LOSSES

You have seen from the above discussion that sometimes it is not possible to set off the entire loss from the available incomes or profits. In that case the losses can be carried forward to the following year.

The carried forward losses are set off next year. There are many rules for carry forward and set off which we will discuss slowly.

You may ask why should we set off and why should there be carry forward? The answer would be when the laws of the country are securing some income to the government by imposing tax, they must show consideration for those who losses in the process. Secondly, equity demands that persons of equal resources and incomes should be taxed equally. Where a person loses, he will be at par only when he is set off his losses against his incomes.

You should remember that losses under the following heads only could be carried forward for set off:

- a) Business or profession
- b) Speculation
- c) Capital gains
- d) Owning and Maintaining of race horse

(i) Business Losses (Section 72)

Business losses which cannot be set off in the same assessment year because of insufficiency of profits under other heads are carried forward to the following assessment year where they shall be set-off against the profits and gains of any business or profession assessable for that assessment year. The only condition is that the business or profession which yielded the loss originally must continue to be carried on by him in the relevant previous year.

You will remember one thing. The benefit of carry forward and set-off is given to the assessee to help him to continue the business and if he closes the business which yields loss, he must forfeit the right to carry forward.

To illustrate, during the assessment year 1991-92 agency business shows a loss of Rs.1,00,000 and the bullion business a profit of Rs.40,000. After setting off, the net result will be loss of Rs.60,000 which will be carried to the next year for set off.

If the loss cannot be wholly set-off, the balance of loss shall be carried forward to the following assessment year and so on. The maximum period during which the benefit of carry forward is available is 8 years immediately succeeding the assessment year for which the loss was first computed.

(ii) Speculation Losses (Section 73)

Loss from speculation business not set-off in any assessment year shall be carried forward to the following assessment year where it shall be set-off against profit of speculation business carried on by him for the assessment year. No loss can be carried forward for more than 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

(iii) Loss under the Head 'Capital Gains' (Section 74(1))

Loss under the head 'Capital gains', which cannot be set off in the same year shall be carried forward for the next eight assessment years and set off against the income under the head 'Capital gains'.

However, with regard to long term capital loss of the assessment year 1990-91, it should be first scaled down as per the provisions of Section 48(3) and only the reduced amount will be allowed to be set off against income from any other head (including short-term capital gains). The unabsorbed long term capital loss, if any will be carried forward up to a maximum period of eight assessment years subsequent to the assessment year in which it is first computed and to be set off against capital gains only.

To provision of scaling down applies even to the long term capital losses carried forward to the assessment year 1990-91 from the earlier assessment years. However the unabsorbed capital loss of these earlier years will be carried forward to be set off against capital gains for a maximum period of four assessment years subsequent to the assessment year in which it was first computed.

(iv) Losses on Race Horses (Section 74 A(iii))

Where the assessee incurs a loss on maintaining and running the horses for races, such loss first of all can be set-off against his winnings from race and then remaining portion can be carried forward to the following assessment year and so on. However, no portion of the loss shall be carried forward for more than four assessment years immediately succeeding the assessment year for which the loss was first computed. Next year also the brought forward loss will be set-off against his income from races including the stake money. The only condition is that the activity of owning and maintaining race horses is carried on by him in the previous year relevant to the assessment year when the brought forward loss is sought to be set-off.

Suppose an assessee does not maintain a race horse but losses some money in horse race, such loss cannot be carried forward to the following year. It is only the loss incurred by the assessee who maintains a race horse that can be carried forward for set-off to the following year and so on.

Note: A new section 71A will come into force w.e.f. the A.Y. 1993-94, which relates to the carry forward of loss under the head 'House Property'. According to this section, loss under the head income from house property shall be carried forward so far as it relates to interest on borrowed capital to the following assessment years and set off against income under the same head.

Check Your Progress - 3

How do you carry forward and set-off Business Loss, and Speculation Loss?

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16.6 CARRIED FORWARD IN SPECIAL CASES

Having discussed the set off and carry forward in general, we will here under discuss carry forward in special cases.

(i) Business Rehabilitated

It is a special situation where an industrial undertaking carried on by the assessee is sometimes discontinued because of flood, riot, explosion, war, etc. In general, due to these situations, the loss arising due to loss of assets is terminal depreciation. When due to flood etc. the business has come to a close, the question of carry forward of such losses does not arise. However, Section 72(i) of the Act provides that if the business is revived, reestablished or reconstructed by the assessee within three years, such loss could be carried forward for set off against future profits. The only condition is that the business so reconstituted, re-established or reviewed etc., must continue. The loss can be carried forward for a maximum period of eight years from the year in which the business was re-established, etc.

(ii) Losses of Registered Firm (Section 75)

The registered firm is not allowed to carry forward and set off its losses itself. Losses incurred by registered firm are allocated to partners and they will be eligible to the benefit of carry forward and set off. Similarly, if there is any unabsorbed depreciation which the firm is not able to set off, it will be allocated to partners and they would claim the benefit of set off and carry forward and set off.

The above provision applies even to un-registered firms assessed as registered firms under section 183 (Section 76).

(iii) Losses of Unregistered Firm (Section 77)

Unregistered firm is assessed like an individual. It is entitled to carry forward its losses and set off in the year to come. Partners of an unregistered firm are, therefore, not allowed the benefit of carry forward and set off.

Note: The above three sections (75, 76 and 77) are being omitted w.e.f. the A.Y. 1993-94. In their place only one new section with No. 75 will come into force whereby the unabsorbed loss of a firm will be apportioned among the partners first and if that loss cannot be set off by the partners other incomes individually, then such loss will be allowed to be carried forward for set off by the firm.

(iv) Carry Forward and Set Off Losses in Case of Change in Constitution of Firm or on Succession (Section 78)

We have stated above that the benefit of carry forward and set off is allowed to the person who has suffered the loss provided the business which ended up with the loss continues to exist and the assessee also continues to take part in it. In accordance with this general principle, where a change has occurred in the constitution of a firm registered or unregistered, the loss attributable to the outgoing partners shall not be available either to the firm or to the partners for set off or carry forward and set off.

Note: A new sub-section (1) of section 78 will come into force in place of existing section. As per this, where there is a change in the constitution of the firm, the share of loss of the outgoing partners shall not be carried forward to be set off against the income of the new firm.

(v) Unabsorbed Depreciation

Depreciation is a necessary element of cost and therefore, it is allowed. However, it is allowed only when there are profits and to the extent it can be absorbed by the existing profits. In case there are insufficient profits or there are no profits at all, there is bound to remain some depreciation which remains unabsorbed.

Unabsorbed depreciation is carried forward to the following year for absorption there. It is treated at par with that year's depreciation. It means that it can be absorbed by income under any head. It is not necessary that there should be profits under the head 'business and profession' to absorb depreciation. It can be carried forward for an unlimited period.

To illustrate, suppose there is a business loss of Rs. 56,000 and unabsorbed depreciation of Rs. 45,000 in the assessment year 1991-92. For the assessment year 1992-93, the particulars of income etc. are as follows.

	Rs.	Rs.
Business Profits	50,000	
Income from house property	70,000	
Current year's depreciation	10,000	
The computation of Gross total income will be done as follows:		
	Rs.	Rs.
1. Income from House Property		70,000
2. Business profits:	50,000	
Loss: B/F loss from 1991-92 A.Y.	56,000	
	<u>6,000</u>	
To be carried forward loss		Nil
Depreciation: current year	10,000	
B/F	<u>45,000</u>	55,000
Gross Total Income		<u>15,000</u>

Note: It has been assumed that the business continues to operate during the relevant previous year.

(vi) Unabsorbed Investment allowance

In respect of new plant and machinery acquired before 01.04.1990 and used for manufacturing purposes, investment allowance is allowed at a rate of 25 percent of the cost of plant and machinery. In case the profits of the firm are inadequate, certainly some of the allowance will remain unabsorbed. Such unabsorbed investment allowance will be carried forward to the next year for set off. It can be carried forward for a period of eight years.

(vii) Submission of Return of Loss

It has been made obligatory for the assessee who wishes to avail himself of the benefit of carry forward to file a return voluntarily and have his loss determined. If the assessee does not file his return in time, he loses the benefit of forward his losses.

16.7 ILLUSTRATIONS

1. The following particulars are supplied to you by Mr. Barua having the status of a resident in India and you are requested to compute his gross total income for the assessment year 1992-93, keeping in view the various provisions relating to set-off losses.

	Rs.
Income from house property A	4,000
Loss from house property B	5,000
Loss from registered firm	20,000
Profit from speculation business	45,000
Loss from short-term capital assets	5,000
Long term capital gains	4,000
Long term capital loss arising from transfer of a building	10,000
Interest on securities	15,000

Solution

Income from House property:

(i) 'A'	4,000	
(ii) Loss from house property B	<u>-5,000</u>	-1,000

Profit from business:

Profit from speculation	45,000	
Loss from a registered firm	<u>-20,000</u>	25,000
Loss from short-term capital assets		-5,000
Long-term capital gains	4,000	
Less: Deduction under Section 48 (ii)	<u>4,000</u>	Nil
Long-term capital loss	10,000	
Less: Deduction u/s 48 (3)	<u>10,000</u>	Nil
Interest on securities		15,000
Gross Total Income		<u>34,000</u>

2. Mr. Nair a resident of Kerala submits the following particulars of his income for the assessment year 1992-93:

	Rs.
Income from let out house (computed)	8,000

Income from residential house	Nil
Profits from radio business	19,600
Share from a registered firm	1,800
Speculation Income	1,900
Short-term capital gains	3,200
Long-term capital gains	8,500

The following items have been brought forward from the preceding assessment year 1991-92.

i) Loss from Cycle Business-discontinued during the previous year 1990-91	3,900
ii) Share of loss in the firm	2,700
iii) Loss from Radio business	1,900
iv) Unabsorbed depreciation	1,000
v) Unabsorbed investment allowance	1,100
vi) Family planning expenditure	2,600
vii) Speculation loss	3,200
viii) Short-term capital loss from the A.Y. 1990-91	4,100
ix) Long-term capital loss from the A.Y. 1990-91	7,900
Current year's depreciation amounted to Rs.500	

You are required to compute his Gross Total income and deal with carry forward of losses.

Solution	Rs.	Rs.	Rs.
Income from house property (letout)			8,000
Profits from Business:			
Radio Business	19,000		
Profit from Regd. firm	<u>1,800</u>		
	21,400		
Less: Current Depreciation	<u>500</u>	20,900	
Less: Brought forward losses:			
Loss from Radio business	1,900		
Loss from Regd. firm	2,700		
Unabsorbed Depreciation	1,000		
Unabsorbed investment Allowance	<u>1,100</u>	<u>6,700</u>	
			14,200

Profit from Speculation	1,900	
Brought forward speculation losses	<u>3,200</u>	
Loss carried forward to 1993-94 A.Y.	<u>1,300</u>	
Capital Gains:		
Long-term capital gains	8,500	
Less: Deduction u/s.48	<u>8,500</u>	Nil
Long-term capital loss brought forward from 1990-91	7,900	Nil
Less: Deduction u/s 48(3)	<u>7,900</u>	
Short-term capital gains	3,200	
Less: Short-term capital losses b/f. from 1990-91	<u>4,100</u>	
Loss to be carried forward to 1993-94 A.Y.	<u>900</u>	
Gross Total Income		<u>22,200</u>

Notes

1. Family planning expenses are allowed only in the case of company assessees.
2. Long-term capital losses brought forward from earlier year are to be scaled down u/s 48 before they set off and carry forward.

16.8 SUMMING UP

This unit consists of the rules of set off and carry forward and set off of losses. There are several rules, to be followed while permitting set off of losses. First we set off any loss from one source against any other source under the same head. The losses of one head are set off against the profits of other heads. While doing so we see that losses from speculation are set off only against such profits. However, losses from other sources can be set off against profits from speculation.

The losses from business, capital gains, speculation etc. are carried forward for set off if in a particular assessment year there are no profits available for set off. However, once again we will set off speculation losses only against speculation profits. There is one more condition in regard to carry forward & set off. It is necessary that the business which resulted in losses must continue to exist and operate when the carried forward losses come up for set off. In other words, losses from a business which have been discontinued will not be allowed to be set off against profits of a newly started business.

16.9 CHECK YOURS PROGRESS: MODEL ANSWERS

1. Speculation loss can be set off from speculation gain only. But loss from any other source can be set-off from speculation profit.

2. Loss from one head of income can be set off against income of another head, except (i) Speculation Loss; (ii) Losses from the activity of owning and maintaining race horses; (iii) Loss from a source, income from which is exempt; (iv) Loss under the head 'capital gains'.
3. (i) Business loss can be carried forward for 8 previous years succeeding the relevant previous year to be set-off from any business incomes. Loss of discontinued business cannot be carried forward.
(ii) Speculation loss can be carried forward for 8 succeeding previous years to be set off only from speculation gain.

16.10 MODEL EXAMINATION QUESTIONS

I Essay Questions

Answer the following essay questions in about 30 lines each.

1. Explain the provisions of set off of losses.
2. What are the provisions of carry forward and set off of losses?
3. How do you treat the following:
 - a) Unabsorbed depreciation
 - b) Unabsorbed investment allowance
 - c) Losses of registered firm.
4. Explain the rules with regard to the following:
 - a) Business rehabilitated
 - b) Losses of unregistered firm.
 - c) Carry forward business losses.
5. The following particulars are submitted to you by Reddy Brothers, Bombay for computing income for the assessment year 1992-93.

	Rs.
Losses from business	20,000
Income from the house property (computed)	8,000
Interest on securities	80,000
Income from other sources	20,000
Brought forward business losses from A.Y. 1991-92	50,000
Unabsorbed depreciation from A.Y. 1991-92	80,000

II Short Questions

Answer the following short questions in about 15 lines each.

1. Explain exempted incomes.
2. Explain deemed incomes.
3. How do you treat losses on race horses?
4. Explain the rules for set off of losses under the head 'Capital Gains'.
5. What are the rules for set off losses under the head income from other sources.
6. Explain the following:
 - i) Aggregation,
 - ii) Carry Forward Loss, and
 - iii) Speculation losses.

UNIT 17: DEDUCTIONS FROM GROSS TOTAL INCOME - I

Contents

- 17.0 Aims and Objectives
- 17.1 Introduction
- 17.2 Deductions in respect of Certain Payments
- 17.3 Illustrations
- 17.4 Summing Up
- 17.5 Check Your Progress: Model Answers
- 17.6 Model Examination Questions

17.0 AIMS AND OBJECTIVES

The objective of this unit is to explain you the deductions allowed from Gross Total Income in respect of certain payments.

After reading this unit, you should be in a position to:

- * discuss the deductions allowed from Gross Total Income in respect of certain payments, like savings, donations etc.

17.1 INTRODUCTION

We have earlier stated that the computation of total income is the basis of determining one's tax liability. You have been shown the process of calculating taxable income under various heads of income, provisions pertaining to clubbing of incomes and rules regarding set off and carry forward and set off of losses. All this gives you the gross total income of the assessee. Out of the gross total income so arrived at, a few deductions are allowed. This is the last step of computation of total income which is the basis of tax liability. These deductions are allowed in respect of savings, etc.

Various rules in this regard are as follows:

1. In computing the total income of an assessee, there shall be allowed from his gross total income the deductions specified in sections 80 CCA to 80 U.
2. The aggregate amount of deduction under these provisions shall not in any case exceed the gross total income of the assessee.
3. Where in computing the total income of a firm, association of persons or body of individuals any deduction is admissible under the following sections, no deduction under the same section shall be made in computing total income of the partner of the firm or member of the association of persons, etc.

Note: W.e.f. the A.Y. 1993-94 the word "Firm" is to be dropped from the above sub-sections (3).

All of the following deductions are proposed to be discussed in this unit and the next one. Once you have completed the study of these two units, you may be able to help assesseees in securing tax advantages.

1)	80	CCA	13)	80	HHE
2)	80	CCB	14)	80	I
3)	80	D	15)	80	IA
4)	80	DD	16)	80	JJ
5)	80	G	17)	80	L
6)	80	GG	18)	80	O
7)	80	GGA	19)	80	Q
8)	80	HH	20)	80	QQA
9)	80	HHA	21)	80	R
10)	80	HHB	22)	80	RR
11)	80	HHC	23)	80	RRA
12)	80	HHD	24)	80	U

17.2 DEDUCTIONS IN RESPECT OF CERTAIN PAYMENTS

We have stated elsewhere that the fiscal laws are not only used to collect revenues but also encourage people to channelise their income in certain directions. If the Government is interested in more savings, it will give some relief by way of deductions in respect of savings; if it wants donations for certain causes, it will give deduction in respect of donations made by the assessee for those causes. All such types of deductions will be discussed in this unit.

i) Deduction in respect of Deposits under National Saving Scheme or Payment to a Deferred Annuity Plan (section 80 (CCA))

- i) This deduction will be allowed to:
 - a) an individual
 - b) a HUF, and
 - c) an association of persons or body of individuals consisting only of husband and wife governed by the system of community of property in Dadra, Nagar Haveli, Goa, Daman and Diue.
- ii) This deduction is available only when the specified person has in the previous year:
 - a) deposited any amount in such scheme as notified by the Central Government; or
 - b) Paid any amount to effect to keep in force a contract or such deferred annuity plan of the LIC as the Central Government may notify in the official gazette, (amounts paid under Jeevan Dhara and Jeevan Askshya policies issued by the LIC qualify for deduction under this section)
- iii) The deduction will be allowed equivalent to the amount deposited or paid up to a maximum of Rs.30,000 for the Assessment year 1989-90 and 1990-91. This limit is increased to Rs. 40,000 w.e.f. A.Y. 1991-92.

- iv) The amount of interest accruing in the Deposit Account shall be exempt.

Note: The above deduction will be dropped w.e.f. the A.Y. 1993-94.

ii) Equity Linked Savings Scheme (Section 80 CCB).

This is a new section introduced with effect from A.Y. 1992-92. A deduction respect of investment made in the units of any plan, framed in accordance with the Equity Linked Saving Scheme, of the Mutual Funds specified under clause (23D) of Section 10 of UTI. The deduction shall be allowed on so much of the amount invested as does not exceed Rs.10,000. However, this deduction will be withdrawn w.e.f. A.Y. 1993-94.

iii) Deduction in respect of Medical Insurance premia: (Section 80 D)

In computing total income of an assessee, there shall be deducted an amount up to Rs.3,000 paid by him by cheque in the previous year out of his income chargeable to tax in respect of the following:

- a) Where the assessee is an individual, any sum paid to effect or to keep in force an insurance on the health of the assessee or on the health of the wife or husband, dependent parents or dependent children of the assessee.
- b) Where the assessee is an HUF, any sum paid to effect or to keep in force an insurance on the health of any member of the family.

It is necessary that such insurance shall be in accordance with a scheme framed in this behalf by the General Insurance Corporation of India and approved by the Central Government.

Note: The amount of deduction is increased to Rs.6,000 w.e.f. the A.Y. 1993-94.

iv) Deduction in respect of Medical Treatment of Handicapped Dependents: (Sec 80 DD)

Under this new section introduced w.e.f. AY 1991-92, deduction of a sum of Rs.6,000 shall be allowed in the case of individuals and HUFs, resident in India, who incur expenditure on medical treatment, training and rehabilitation of a person suffering from a permanent physical disability or mental retardation. This deduction will be available only to those assessee whose total income before this deduction does not exceed Rs.1,00,000 a year. Further, the person suffering from permanent physical disability or mental retardation is a relative of the individual or in the case of HUF, is a member of the joint family and is in either case wholly dependent on the assessee. The disability should be certified by a medical doctor or psychiatrist working in a Government Hospital.

Note: W.e.f. the A.Y. 1993-94, the amount of deduction under the above section will be increased to Rs.12,000 be dropped. Further the income limit of Rs.1,00,000 to avail the above deduction will be dropped.

v) Charitable Donations: (Section 80 G)

You will agree donations in the society should be encouraged. Anyone who donates should be treated favourably and in fiscal matters also some consideration should be shown to him. However, if we start giving sympathetic consideration to all types of donations, there is a possibility when assessee might start donating amounts to those agencies which are controlled by them and which rarely do any good to the society. It is therefore necessary that the tax laws made specific mention of those donations which will be treated favourably for tax deductions. Section 80G is a section that deals with various aspects of donations.

Section 80 G grants full or partial deduction in respect of amounts given as charitable donations. Deductions must be given to those agencies which are approved and the amount should also be within limits in certain cases. When all these conditions are complied with, deduction for donation would be allowed.

1. Approved Agencies

Donations given to the following qualify for deduction under this Section.

- A.
 - (i) The National Defence Fund set-up by the Central Government
 - (ii) The Jawaharlal Nehru Memorial Fund
 - (iii) The Prime Minister's Drought Relief Fund
 - (iiia) The Prime Minister's National Relief Fund
 - (iiiaa) The Prime Minister's Armenia Earthquake Relief Fund.
 - (iiiab) The Africa (Public Contributions - India) Fund
 - (iiib) The National Children Fund
 - (iiic) The Indira Gandhi Memorial Trust
 - (iiid) The Rajiv Gandhi Foundation
 - (iv) Any other Fund or institution to which this section applies.
 - (v) The Government or any local authority to be utilised for any charitable purposes other than the purpose of promoting family planning.
 - (vi) Any authority constituted in India by or under any law enacted for the purpose of housing accommodation, planning, development or improvement of cities, towns and villages.
 - (vii) The Government or any such local authority, institution or association as may be approved in this behalf by the Central Government to be utilised for the purpose of promoting family planning.
- B. Any donation for the renovation or repair of any such temple, mosque, gurdwara, church or other place as is notified by the Central Government. They shall be of historic, archaeological or artistic importance or a place of public worship renowned throughout any state or states. The notification will come in the official gazette.

2. Qualifying Amount

A. Minimum Amount

The assessee is not allowed any deduction under this section if the aggregate of the sums referred to above is less than Rs.250.

B. Maximum Amount

There is no maximum limit prescribed for donations to the following funds and assessee is completely free to donate any he likes to them:

- i) The National Defence Fund set-up by the Central Government.

- ii) The Jawaharlal Nehru Memorial Fund.
- iii) The Prime Minister's Drought Relief Fund.
- iiia) The Prime Minister's National Relief Fund.
- iiiaa) The Prime Minister's Armenia Earthquake Relief Fund.
- iiiab) The Africa (Public Contributions-India) Fund.
- iiib) The National Children Fund.
- iiic) Indira Gandhi Memorial Trust.
- iiid) The Rajiv Gandhi Foundation.

In case the assessee donates to agencies other than the ones stated above, the maximum limit is Rs.5,00,000 or 10 percent of the total adjusted income, whichever is less. Total adjusted income in this context means the gross Total income as reduced by the following:

- a) All permissible deductions from Gross Total Income excepting the deduction on account of the donation itself.
- b) Share of profit from an unregistered firm, an association of persons where the firm or the association has paid tax.
- c) Interest on tax free Government securities.

3. Rate of deduction

Deduction at the following rates will be allowed to any person in respect of the qualifying donation:

A. 100 percent of the donations made to the following:

- a) Prime Minister's National Relief Fund.
- b) Prime Minister's Armenia Earthquake Relief Fund.
- c) The Africa (Public Contributions- India) Fund.
- d) Government etc. for utilisation in promoting Family planning.

B. 50 percent of other approved donations within qualifying amount.

4. Steps Involved

- a) See Whether the donations have been given to approved institutions.
- b) Total donation during the previous year should not be less than Rs.250
- c) Donations to the following have no maximum limits:

The National Defence Fund.

The Jawaharlal Nehru Memorial Fund.

The Prime Minister's Drought Relief Fund.

The Prime Minister's National Relief Fund.

The Prime Minister's Armenia Earthquake Relief Fund.

The Africa (Public Contributions-India) Fund.

The National Children Fund.

The Indira Gandhi Memorial Trust.

The Rajiv Gandhi Foundation.

- d) Now add up the remaining donations and see that they are within the maximum limit prescribed above. In case of excess, bring the total down to the permitted amount.
- e) The amounts in (c) and (d) given above have to be aggregated. The total is the qualifying donation.
- f) Out of the qualifying donations find out the following:
Donations which are eligible for 100 percent deductions.
- g) For the balance, that is (e) minus (f), only 50 percent thereof will be permissible.
- h) The total amount of deduction under Section 80 G will therefore be the aggregate of the deduction stated in (f) and (g) above.

This section applies to the funds and charitable institutions which fulfil the following conditions:

- i) Income of the fund, etc., is not includible in its total income under the provisions of section 10(22), 10(22A), 10(23), 10(23C), 11 and 12.
- ii) The income of the fund, etc. is not used for any purpose other than a charitable purpose.
- iii) The fund is not used for the benefit of any particular religious community or caste.
- iv) Regular account of receipts and expenditure is maintained.
- v) It is a registered body under some law.
- vi) The institution or fund is required to be approved by the Commissioner.

Check your Progress - 1

What are the deductions allowed under sections 80 CCA and 80CCB?

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Check Your Progress -2

List out donations for which 100% deduction is allowed.

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ILLUSTRATIONS

Compute total income of the cases given below:

1. Abdulla's gross total income is Rs.4,00,000. He donated Rs.70,000 to a charitable institution and Rs.25,000 to the National Defence Fund set-up by the Central Government.
2. Rejendra's gross total income is Rs.35,00,000. He donated Rs.3,80,000 to Prime Minister's National Relief Fund and Rs.4,00,000 to a Gurdwara notified by the Central Government as place of historic importance.
3. Srivastava's gross total income is Rs.11,00,000. He has donated Rs.3,50,000 to a temple being a palace of archaeological importance according to a notification issued by the Central Government.
4. Shiv Swarup's gross total income is Rs.4,50,000 as he has donated Rs.21,000 to a University and Rs.20,000 to a church which is a place of artistic value. He pays Life Insurance Premium of Rs. 15,000 on a policy of Rs.2,00,000.
5. Prag Mills Ltd's gross total income is Rs. 10,00,000. Amount donated by it during the year comes to Rs.1,00,000 out of which Rs.50,000 have been donated to the Congress Party.
6. Shri Guptha's gross total income is Rs.42,000 out of which he donates Rs.5,000 to Andhra College and Rs.1,000 to an orphanage.

Solution

	Rs.
1)Gross Total Income	4,00,000
Deduction: 50% of the qualifying donations i.e. 65,000	32,000
	<u>3,67,500</u>

Qualifying donations

	Rs.	Rs.
1.Donation to a charitable institution being restricted to 10% of Gross Total Income	40,000	
ii.Contribution to National Defence Fund	25,000	
	<u>65,000</u>	

2.Gross Total Income	35,00,000
Less: Deduction u/s 80 G	5,55,000
	<u>29,45,000</u>

Qualifying Amount u/s 80 G :

i) Donation to PM's NRF	3,80,000
ii) Donation to Gurdwara	3,50,000
	<u>7,30,000</u>

In case of donation to Gurdwara either actual donation Rs.4,00,000 or 10% of GTI, i.e., 3,50,000 - w.e. is less qualifies.

Amount Deductible u/s 80 G:

	Rs.
1) Donation to P.M.'s NRF - 100%	3,80,000
2) Donation to Gurdwara - 50% of qualifying amount (3,50,000 x 50 / 100)	1,75,000
	<u>5,55,000</u>

3. Gross Total Income

	Rs.
	11,00,000
Deduct: 50% of the qualifying donation i.e. Rs. 1,10,000	55,000
Total Income	<u>10,45,000</u>

Qualifying Donations

Donation to a temple must not exceed 10% of GTI that is Rs.1,10,000

4. Gross Total Income

	4,50,000
Deduction under section 80 G-Donation: 50% of the qualifying donation of Rs.41,000	20,500
Total Income	<u>4,29,500</u>

Qualifying Donations under section 80 G.

Donation to the University and Church Rs.41,000 or 10% or Rs.4,50,000 that is Rs.45,000, which ever is less.

5. Gross Total Income	10,00,000
Deduct: 50% of the qualifying donation i.e. 50,000	25,000
Total Income	9,75,000

Note:- Donation to any political party is not eligible for the relief. It has been assumed that the balance of the donation has been made to approved charitable institution.

6. Gross Total Income	42,000
Deduct: 50% of the qualifying donation i.e. 4,200	2,100
Total Income	39,000

Donation to Andhra College qualifies for relief subject to the maximum of 10% of G.T.I. Amount given to an orphanage can also be allowed provided it is approved and the limit has not been exhausted as in the present case.

v) Deduction in Respect of Rent paid: Section 80 GG

Deduction under this section takes care of situation when an assessee is compelled to pay high rent for the accommodation he is occupying. You may be knowing that persons with similar income but placed in different locations will not be able to pay equal amount to tax because of many economic factors. One of them is rent. A person getting Rs.1,00,000 and staying in Mahaboobnagar in a rental accommodation of Rs.5,000 per annum is placed differently than a person with some amount of income but placed in Bombay where he has to pay Rs.30,000 by way of rent for the accommodation. Naturally, the man in Bombay needs some concession in tax computation. Deduction under this section is meant for this type of situations. The following conditions are necessary to be complied with:

- i) Deduction under this provision will be allowed only to a person who has not been allowed any house rent allowance which is tax free.
- ii) The assessee is entitled to deduction in respect of house rent allowance only when the rent paid by him is in excess of 10 percent of total income. The deduction will be restricted to such excess.
- iii) The maximum deduction under this provision will be either Rs. 1,000 per month or 25 per cent of total income, whichever is less.
- iv) The assessee should not own any house property himself anywhere nor does his spouse, minor child or the HUF of which he is a member should own any house property anywhere.
- v) The deduction under this section shall be allowed only when the accommodation is situated at any one of the following places.
 - (i) Agra, Ahmedabad, Allahabad, Amritsar, Bangalore, Bhopal, Calcutta, Coimbatore, Delhi, Faridabad, Gwalior (Laskhar), Hyderabad, Indore, Jabalpur, Jaipur, Kanpur, Lucknow, Ludhiyana City, Madhurai, Nagapur, Patna, Poone, Srinagar, Surat, Vadodara (Baroda) or Varanasi or the urban agglomeration of each of such places.
 - (ii) Bombay, Calicut, Cochin, Ghaziabad, Hubli-Dharwad, Madras, Sholapur, Trivendrum or Vishakhapatnam.

ILLUSTRATION

Rajan is employed on salary of Rs. 50,000 p.a. with no other allowance or perquisite. His share of profit from a registered firm is Rs. 25,000. He is insured for Rs. 1,00,000 and pays annual premium at Rs. 7,500. He lives in a rental house at Bangalore and pays annual rent of Rs. 10,000. He donated Rs. 6,750 to the Africa (Public Contribution-India) Fund. Calculate his total income for the assessment year 1992-93.

Solution	Rs.	Rs.
Salary	50,000	
Less : Standard Deduction	12,000	
		38,000
Share of Profit from Regd. Firm		25,000
		63,000
Gross Total Income		
Less: Deduction u/s 80 G (100%)	6,750	
u/s 80 GG	4,375	
		11,125
Total Income		51,875

Qualifying Amount for rebate of tax:

Life Insurance premium of Rs. 7,500 on a capital sum of Rs. 1,00,000.

Note:

Deduction under section 80 GG has been calculated at below:

Gross Total Income	63,000
Deduction (excepting section 80 GG)	6,750
Total Income for the purpose	56,250
Rent paid for the accommodation	10,000
10% of total income calculated above	5,625
Excess Rent Paid	4,375

- Rs. 1,000 P.M. - Rs. 12,000
 - 25% of GTI $(56,250 \times 25 / 100) = \text{Rs. } 14,062$
 - Rent Paid - 10% of GTI = Rs. 4,375
- Which ever less is deductible u/s 80 GG.

vi) **Deduction in respect of Certain Donations for Scientific Research or Rural Development: Section 80 GGA**

Government is also interested in seeing that the country makes progress in the areas of scientific research and rural development. It is therefore, stated in this section that donations meant for scientific research and rural development may also be treated favourably. In fact such donations are treated so while computing taxable income under the head business or profession.

Now if an individual makes donation to such institutions, if he is not engaged in business, will get deduction under this section in respect of such donations.

1. Scientific Research

Any sum paid by the assessee in the previous year to a scientific research association which has as its object the undertaking of scientific research or to a university, college or other institution to be used for scientific research. The only condition is that such association, university etc. is for the time being approved for the purpose of Section 35 (1) (ii).

Further any sum paid by the assessee in the previous year to a University, College or other institution to be used for research in social science or statistical research will also be eligible for deduction under the above section w.e.f. the A.Y. 1992-93. Such university, college or institution should have been approved for the purpose of clause (iii) of sub-section (1) of section 35.

2. Rural Development

Any sum paid by the assessee in the previous year to an association or institution which has as its object the undertaking of any programme of rural development approved for the purpose of section 35 CCA. Associations and institutions which trains persons for implementing programmes of rural development are also eligible to collect funds under this section provided they are for the time being approved for the purpose of section 35 CCA(2)

Provided that the assessee furnishes the certificate referred to in section 35 CCA (2) or 35 CCA (2A) from such association or institution.

Further any sum paid by the assessee in the previous year to a Public Sector company or a local authority or to an association or institution approved by the national committee for carrying out any eligible project or scheme will also be eligible for deduction under this section w.e.f. the A.Y. 1992-93.

3. 9 National Fund for Rural Development

Any sum paid by the assessee in the previous year to a National Fund for rural development set up and notified by the Central Government for the purpose of section 35 CCA.

4. Conservation of Resources or of Afforestation.

Any sum paid by the assessee to an association or institution which must have as its object the undertaking of any programme of conservation of natural resources or of afforestation to be used for carrying out any programme approved under section 35 CCB. Another condition is that such association etc. is also for the time being approved for the purpose of said section.

Check Your Progress - 3

What is the deduction available under Section 80 GGA

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17.3 ILLUSTRATIONS

1. Robert's income from various sources is as follows:

Salary	Rs.	36,000
Income from other sources	Rs.	25,000

He pays Rs.5,000 by way of premium on his life insurance of Rs. 1,00,000 and buys National Savings Certificates of Rs.10,000. He donates Rs.3,000 to Govt. for promoting family planning programme.

Solution

Salary	36,000
Standard deduction	<u>12,000</u>
Taxable Salary	24,000
Income from other sources	25,000
Gross Total Income	<u>49,000</u>
100% of donation of Rs.3,000	3,000
Total Income	<u>46,000</u>

Qualifying Amount for rebate of tax u/s 88:

1. Life Insurance Premium	5,000
2. National Savings Certificates	<u>10,000</u>
	<u>15,000</u>

Note: Donation to Govt. for promotion of family planning programme is deductible in full.

2. Miss Lata is a playback singer and earns gross remuneration of Rs.1,00,000 during the previous year 1991-92. She incurs Rs.30,000 on items necessary to her profession. She pays Rs.10,000 as her contribution to Public Provident Fund on which the interest credited is Rs.5,000. She donates Rs.10,000 to National Defence Fund. Calculate her total Income.

Solution

Gross Income from profession	1,00,000
Allowable expenses	<u>30,000</u>
Gross Total Income	70,000

Deductions Allowed

Approved Donations:

50 percent of Rs.10,000	<u>5,000</u>	5,000
Total Income		<u>65,000</u>

Qualifying Amount for Rebate Tax u/s 88

Contribution to Public Provident Fund Rs. 10,000

- Note:** 1. Interest on public provident fund is not to be taken into account. It is totally tax free.
2. Contribution to National Defence Fund qualifies for deduction without any limit. Therefore, the full amount of Rs.10,000 will be deductible at the rate of 50 percent.

17.4 SUMMING UP

Deductions from gross total income is an important segment of the process of determining total income. It is the quantum of total deductions allowable that will ultimately decide the total income in respect of which the assessee pays tax.

Deductions have been allowed in respect of the following:

- A. How the assessee has disposed of his income?
- B. What type of incomes have been included in gross total income?

The deductions under (A) pertain to savings, donations and certain necessary expenses which are incurred by the assessee. Where he is required to pay higher rents for his accommodation, he is allowed deduction. These deductions in respect of certain payments are allowed under sections, 80 CCA, 80 CCB, 80 D, 80 DD, 80 G, 80 GG, and 80 GGA.

17.5 CHECK YOUR PROGRESS: MODEL ANSWERS

1.
 - i) Under Section 80 CCA, deduction is allowed for the amount deposited in National Savings Scheme. It can be claimed by individual and HUF assesses. 100% of such amount deposited in this Scheme or Rs.40,000 w.e is less shall be allowed as deduction from total income.
 - ii) Under Section 80 CCB, deduction is allowed in respect of amount invested in units of Mutual Funds (Equity Linked Savings Scheme). This can be claimed by individual and HUF assessee. The deduction will be 100% of such amount invested or Rs.10,000 w.e.is less.
2.
 - i) Donation to Prime Minister's National Relief Fund.
 - ii) Donation to Prime Minister's Armenia Earthquake Relief Fund.
 - iii) Donation to Africa (Public Contributions - India) Fund.
 - iv) Donation for Promotion of Family Planning in India
3. Under Section 80 GGA, deduction is allowed for donation given for rural development programme, scientific research etc. All such assessee except those who are not engaged in business can claim this deduction. The actual amount given as donation in the previous year is allowed.

17.6 MODEL EXAMINATION QUESTIONS

I Essay Questions

Answer the following essay questions in about 30 lines each.

1. What are the steps involved in allowing deduction for approved donations?
2. Are the following approved donations:
 - a. Help to a poor student in financing his studies.
 - b. Subscription to a political party.
 - c. Donation to an orphanage.
 - d. Helping a relative in the marriage of his daughter.
 - e. Donation to a temple.
 - f. Donation to Municipal Board in furtherance of family planning programme.
 - g. Donation to Chief Minister's Relief Fund.
 - h. Donation to National Defence Fund.
 - i. Donation to a College in your town.
 - j. Life Membership of an educational institution.
3.
 - a. Rahim's gross total income is Rs.50,000. He pays Rs.2,000 by way of his contribution to Public Provident Fund, Rs.3,000 as life insurance premium, Rs.200 to Jawaharlal Nehru Memorial Fund, Rs.500 to Prime Minister's National Relief Fund. Calculate his total income.
 - b. Shivashanker's gross total income is Rs.75,000 and he subscribes Rs.30,000 under National Savings Scheme during the previous year 1991-92 and donates Rs.10,000 National Defence Fund. Calculate his total income.

II. Short Questions

Answer the following short questions in about 15 lines each.

1. Describe the provisions for deduction in respect of rent paid.
2. What type of deduction is available for donations for Scientific Research or Rural Development.
3. What are the maximum and minimum limits in respect of charitable donations?
4. Enumerate the approved agencies for donations.
5. Summarise the provisions relating to deduction in respect of Equity Linked Savings Scheme.
6. Explain the provisions relating to deduction in respect of deposits under National Savings Scheme.

UNIT-18: DEDUCTIONS FROM GROSS TOTAL INCOME - II

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18.0 AIMS AND OBJECTIVES

The objective of this unit is to discuss deduction in respect of certain incomes which have been included in Gross Total Income. Concessions are also allowed when income has been derived in a particular way or from a particular source. This concessional treatment will be the subject matter here.

After completing this unit, you should be able to:

- * explain deductions that are allowed in respect of certain incomes from gross total income.

18.1 INTRODUCTION

We have discussed the concession being shown when the assessee saves for the future or when he is required to pay heavy rent which reduces his disposable income. Similarly if the assessee invests some amount in shares of a new issue where he will be required to wait for a few years before being in a position to receive dividends, there is some concession.

The law is helpful in certain other matters too. Where the assessee is in receipt of certain incomes which are helpful, concession is shown by the Act. As has been discussed earlier fiscal laws are being used not only for collecting revenues, but also giving direction to the economy. For example, if we are certainly interested in small scale units, we can provide for concessional treatment to profits from small scale units. On the other hand, if we are interested in encouraging industries, we may provide for tax holiday in the Act, that is we may say that profits from newly established industrial units will not be taxed for a period of five or ten years. We will study this type of concessions in this unit.

Since we are not including companies for your course, all those concessions which are shown to company form of organisation, are being excluded from our treatment.

18.2 DEDUCTIONS IN RESPECT OF CERTAIN INCOMES

- I) Deduction in Respect of Profits and Gains from newly Established Industrial Undertakings or Hotel Business in Backward Areas (80 HH)

This provision helps establishment of new industries in backward areas. Suppose you want to start an industrial unit and the Government tell you that if you start the unit at place X, they will either not charge tax or they will treat you concessionally in tax matters. You would naturally be inclined to start the unit there if other things remain the same. Thus backward areas will have industries and their inhabitants will have employment opportunities. We are giving below salient features of this section.

i) Concession

The assessee deriving profits and gains from a newly started industrial undertaking or the business of a hotel set up in specified backward areas will be entitled to a deduction of an amount equal to 20 percent of such profit and loss. The backward areas have been listed in the Eighth Schedule.

ii) Period of Deduction

In case of new units in backward areas, the deduction under this section will be allowed for a period of ten assessment years. The first assessment year will be one which is relevant to the previous year in which the industrial production commences or the hotel starts functioning. For example, where the production commence in June, 1984 and the accounts are finalised for the first time on 31st December, 1984, the first assessment year for this previous year would be 1985-86. Deduction under this section will therefore be available till the assessment year 1994-95.

iii) New Industrial Undertaking or Hotel

- a) It must start manufacture of articles or the hotel must start functioning during the relevant previous year.
- b) It is not formed by the splitting up or the reconstruction of a business already in existence.
- c) It is not formed by the transfer to a new business or hotel of machinery or plant previously used for any purpose in any backward area.
- d) The hotel is for the time being approved by the Central Government.
- e) The industry must employ 10 or more workers in the manufacturing process when it is carried on with the aid of power and 20 or more workers when it is carried on without the aid of power.
- f) It must start functioning after 31-12-1970, but before 1-4-1990 in any notified backward area.

iv) Other points

- a) The tax concession is available to all assessee.
- b) The assessee shall have to submit accounts duly audited along with a copy of the audit report by the Chartered Accountant along with the return of income.
- c) In case there are inter firm transfers under the ownership of the same assessee and it appears to the A.O. that the consideration does not correspond with the market price, then the A.O. shall compute profits as if the transfer had been made at the market value.
- d) Deduction under this section shall not be allowed to a Hindu Undivided Family which at any time during the previous year has at least one member whose total income of the previous year exceeds the maximum amount not chargeable to tax.

II) Deduction in respect of Profits and gains from Newly Established Small Scale Industrial Undertakings in Certain Areas: Section 80 HHA

This section gives benefit to those new industries which are set up in rural areas. The Government of India is interested in getting industries to rural areas and therefore this section will play an important role in creating employment opportunities in rural areas. Unlike section 80 HH, this section helps only small scale industrial undertakings.

i) Concession

An assessee is deriving any profits and gains from a newly started small scale industrial undertaking set up in any rural area is entitled to a deduction of an amount equal to 20 percent of such profits and gains.

ii) Period of Deduction

The deduction under this section is available for a period of ten assessment years. It begins from the assessment year relevant to the first previous year in which the production begins.

iii) Other points

- a) The unit must start manufacturing after 30th September, 1977, but before 1st April 1990 in any rural area.
- b) It must not be formed by the splitting up or reconstruction of an existing business.
- c) It employs ten persons or more when the manufacture is done with power and 20 or more when the production is carried on without power.
- d) The accounts have to be audited by a Chartered Accountant and the audited accounts with the audit report have to be submitted along with the return of income.
- e) An industrial undertaking is deemed to be a small scale industry if the aggregate value of the plant and machinery installed as on the first day of the previous year does not exceed 35 lakhs.
- f) In case the assessee is also entitled to deduction under section 80 HH, deduction under that section shall not be allowed for the same years. In other words deduction will be allowed only under one section and not both the sections.

III) Deduction in Respect of Profits and Gains from Projects Outside India: Section 80 HHB

You might be aware that the country is interested in exports with a view to earning foreign exchange which we need badly. In fact, these days the country's prosperity is judged by the quantum of exports. Exports are of many types. We have traditional exports like tea, coffee etc. Then we have exports of expertise. These days with development of industries and advancement of technology, we are also in a position to export expertise. One of them is the execution of various projects abroad. We are executing different types of projects all over the world. It is the earning from such types of projects that is allowed concessional treatment under this section.

Deduction under this section is allowed to resident tax payer in India who derives any profits and gains from the business of execution of a project under a contract entered into by him with the Government of a foreign state. Earnings from contracts with statutory or public authority or agency in a foreign state are also eligible for deduction under this section.

i) Concession

Deduction at the rate of 50 percent of the profits and gains arising out of execution of projects in foreign countries will be allowed. The projects relate to the construction of any building, road, dam, bridge or other structures outside India, the assembly or installation of any plant and machinery outside India. If the project is pertaining to some other field, then the deduction will be allowed only when the Board of Direct Taxes approves the project for this benefit. The fees must be payable in all such cases in foreign currency.

ii) Period of Deduction

There is no prescribed number of years for deduction under this section. As long as the assessee is in receipt of profits or gains from the execution of projects from foreign countries, he will be allowed deduction under this section.

iii) Other points

- a) The taxpayer is required to maintain separate accounts in respect of the profits and gains from projects.
- b) The accounts will have to be got audited by a chartered accountant and the audit report and the audited accounts must accompany the return of income.
- c) The assessee will be required to credit to a "Foreign Projects Reserves Account" a sum equal to 50 percent of the profits and gains from such project or work. This reserve will be required to be utilised by the taxpayer during a period of five immediately succeeding assessment years for the purpose of the business. It must not be used for distribution by way of dividends or profits.
- d) In case the assessee utilises this reserve for distribution of dividend etc., the A.O. will recompute the profits after withdrawing the deduction.

IV) Deduction in Respect of Export Turnover: Section 80 HHC

This section gives relief by way of deduction to those who are engaged in export business. It encourages assessee to increase their exports and thus claim deduction under this section.

Concession

This concession is available to an Indian company or to other assessee who is resident in India. The deduction will be of an amount calculated as per the following formula:

$$\frac{\text{Profit of the business} \times \text{Export turnover}}{\text{Total turnover}} + \frac{90\% \text{ of export incentive} \times \text{Export turnover}}{\text{Total turnover}}$$

Provided that the deduction under this section shall not exceed the profits derived by the assessee from the export of such goods or merchandise.

In order to get deduction under this section the assessee has to satisfy the following conditions:

1. Goods should have been sent out of India.
2. One has to export eligible goods or merchandise.

3. There must be repatriation of sale proceeds into India in convertible foreign exchange within six months from the end of the previous year or within such further period as the chief Commissioner or Commissioner may for the reasons to be recorded in writing allow.
4. This deduction applies even to those assesseees who export goods manufactured or processed by others.
5. The deduction is not allowed in respect of the following:
 - a) Mineral oils ; and
 - b) Minerals and Ores, other than those sanctioned below:

The benefit of Section 80 HHC will also be allowed to the profits of export of processed minerals and ores specified in the Twelfth Schedule. (w.e.f. 1-4-1991)

v) Deduction in Respect of Earnings in Convertible Foreign Exchange: Section 80 HHD

This deduction is available to the following:

- a) an Indian company, or
- b) any other resident person engaged in the business of a hotel, tour operator or a travel agent.

The amount of deduction will be equivalent to:

- a) 50% of profits derived from services provided to foreign tourists.
- b) so much of the amount of the remaining profits from such services which is debited to the Profit and Loss Account of the previous year and credited to a Reserve Account meant to be utilised as prescribed.

The reserve should be utilised within five years of its credit to the Reserve Account for the following purposes:

- i) Construction of new hotels approved by prescribed authority.
- ii) Purchase of new cars and new coaches by approved tour operators and travel agents.
- iii) Purchase of sports equipment for mountaineering, golf, river rafting and other water sports.
- iv) Construction of conference/convention centres.
- v) Provision of other new facilities as notified for the growth of Indian Tourism.

From the AY 1991-92, the tax payer is required to bring into India the receipts in relation to services provided to foreign tourists, in convertible foreign exchange within a period of six months from the end of the previous year or within such extended period as the Commissioner of Income Tax may allow.

VI) Deduction in respect of Profits from Export of Computer Software, etc.: Section 80 HHE

- 1) In computing the income of an assessee, being an Indian company or a person (other than a company) resident in India, engaged in the business of;
 - i) export out of India of Computer software or its transmission from India to a place outside India by any means; or

- ii) providing technical services outside India in connection with the development or production of computer software, the assessee shall be allowed a deduction in computing his total income.
- 2) **Quantum of deduction** - 100 per cent of the profits derived by the assessee from the aforesaid business.
- 3) **Period of deduction** - The deduction will be allowed in relation to the assessment years 1991-92, 1992-93 and 1993-94.
- 4) **Conditions for deduction:**
 - a) The consideration in respect of the aforesaid business is received in or brought into India by the assessee in convertible foreign exchange within a period of six months from the end of the previous year or within such further period as may be allowed by the Commissioner.
 - b) The assessee furnishes in the prescribed form along with the return of income the report of an accountant certifying that the deduction has been correctly claimed.
- 5) **Computation of profits** - Profits derived from the aforesaid business shall be the amount which bears to the profits of the business, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee.

VII) Deduction in respect of Profits and Gains of Industrial Undertakings (Tax Holiday): Section 80-I

We have earlier discussed that there is a provision of tax holiday in respect of profits and gains from newly started industrial undertaking. Section 80-I permits deduction from such profits.

i) Concession

A deduction of an amount equal to 2 per cent of profits from the newly started industrial undertaking, a ship, business of a hotel or the business of repairs to ocean-going vessels or other powered craft will be allowed in computing the total income of the assessee. For a company assessee the rate of deduction is 25 percent.

ii) Condition: New Industrial Undertaking

- a) It is not formed by the splitting up or the reconstruction of a business already in existence.
- b) It is not formed by the transfer to a new business of machinery or plant previously used for any purpose.
- c) It manufactures or produces any article or thing which is not mentioned in the Eleventh Schedule.
- d) It starts functioning at any time within a period of ten years after 31-3-1981. The period can be extended by the Central Government with reference to any particular industrial undertaking.
- e) The industrial undertaking must employ ten or more workers in a manufacturing process carried on with the aid of power and twenty or more workers where the manufacturing is carried on with the aid of power.

- f) The concession will be available in case of re-establishment, reconstruction or revival by the assessee within the meaning of section 33B.
- g) The concession will be available to all small scale industrial undertakings even when they are manufacturing articles listed in 11th Schedule.

iii) Other points

- a) Though tax holiday is also available in case of ships, hotels and the business of repairs to Ocean-going vessels, these should be owned by an Indian company. If they are owned by individuals or partnership firms etc., such tax holiday will not be allowed. As the company form of organisation is not to be covered in this course, we are excluding all this discussion in case of tax holiday too.
- b) The tax holiday concession is available in computing the total income of the previous year in which the unit starts functioning for the first time. Thereafter it will further be allowed for a period of seven more years. In case, the new unit is owned by a co-operative society, it will be allowed for nine subsequent years in place of seven in other cases.
- c) The accounts have to be got audited by a Chartered Accountant.

The amount and period of deduction is given below:

	Assessee	% of Profit Deductible	Period of Deduction
i)	In case of corporate assessee engaged in the business of repairs to ocean going vessels	20	5 Years
ii)	Any other corporate assessee	25	8 Years
iii)	In case of Coop.Society	20	10 Years
iv)	Any other assessee	20	8 Years

An industrial undertaking which begins to manufacture or a ship which is brought into use or a hotel which starts functioning after 31-3-90 but before 1-4-91 will be eligible for tax concession as follows:

	Assessee	% of Profit Deductible	Period of Deduction
i)	Company	30	10 Years
ii)	Co-op. Society	25	12 Years
iii)	Any other	25	10 Years.

Amendment of Section 80-I

The deduction under section 80-I will be available only to those industrial undertakings which begin to manufacture articles before 1st April, 1991 and those ships and hotels which start functioning before 1st April, 1991. By amending this section the provision of starting the aforesaid business before 1st April, 1995 is replaced by 1st April, 1991.

VIII) Deduction in respect of Profits and Gains from Industrial Undertaking, etc., in Certain Cases: Section 80-1 A

The provisions of newly inserted section 80-1A are almost the same as are of Section 80-I.

However, the following are the noticeable features of this section:

- 1) The assessee must begin to manufacture or produce articles or things or operate cold storage plant in any part of India after 31.3.1991 but before 1-4-1995.
- 2) The ship must be brought into use by an Indian Company after 31.3.1991 but before 1.4.1995.
- 3) The hotel (owned by an India Company) must start functioning:
 - (a) in a hilly area or a rural area or a place of pilgrimage or other notified area by the Central Government after 31.3.1990 but before 1.4.1994;
 - (b) in any other place after 31.3.1991 but before 1.4.1995.

Quantum of deduction	Company	Other Assessee
(1) Industrial Undertakings	30% of Profits	25% of profits
(2) Hotel		
a) Located in a hilly area, rural area or place of pilgrimage	50%	--
b) Located at other places	30%	--
(3) Ship	30%	--

Period for which deduction will be allowed

- (a) in the case of a co-operative society-twelve years;
- (b) in any other case - ten assessment years.

Where a hotel is located in hilly area, rural area or place of pilgrimage and it is approved by the prescribed authority before 31.3.1992, it shall be deemed to have been approved by the authority with effect from assessment year 1991-92 and the deduction under section 80-1A also be allowed from the assessment year 1991-92.

IX) Deduction in Respect Of Profits and Gains Of Poultry Farming: Sec.80 JJ

Under Sec.80 JJ, deduction will be available from the Accounting year 1990-91 in a case where the gross total income of an assessee includes any profits and gains derived from poultry farming. The amount of deduction is equal to $33\frac{1}{3}\%$ of the profits and gains derived from such business.

X) Deduction in Respect of Dividend, Etc.: Section 80 L

We have stated earlier that the Government is interested in mobilising savings and thus encouraging capital formation in the country. Accordingly there is a provision that where the assessee derives income from certain types of interest or dividends etc., and if it is included in his total income, a deduction is allowed in respect of such income. Section 80L enumerates certain interests etc., with respect of which a deduction is permissible.

i) Qualifying Interest

The following interest and dividend qualify:

- (i) Interest on any security issued by the Central or State Government.
- (ia) Interest on National Savings certificates (VI, VII and VIII Issues)
- (ii) Interest on debentures issued by any co-operative society or any other institution notified by the Central Government in this behalf.
- (iii) Interest on deposits under any scheme framed and notified by the Central Government in this behalf.
- (iv) Dividend from any Indian Company.
- (v) Income in respect of units from the Unit Trust of India.
- (vi) Interest on deposits with a banking company including co-operative society engaged in the business of banking.
 - a) Interest on deposits with and such bank established by an Act of Parliament and notified by the Central Government for the purposes of this clause.
- (vii) Interest on deposits with a financial corporation providing long term finance for industrial development in India or a company providing long term finance for construction or purchase of houses in India for residential purposes.
 - (a) Interests on deposits with any authority constituted in India engaged in satisfying housing needs, town planning, improvement of cities, etc.
- (viii) Interest on deposits with a co-operative society.
- (ix) Dividends from any co-operative society.
- (x) Income received from Mutual Fund specified under Section 10 (23D)

A deduction in respect of the above income is allowed subject to maximum limit of Rs. 7,000.

An additional deduction of Rs. 3,000 is allowed in respect of dividends on units of the Unit Trust of India, income from Mutual Fund and interest on deposit with National Deposit Scheme. However, this provision is dropped w.e.f the A.Y. 1993-94.

Another additional deduction upto Rs. 3,000 is allowed in respect of interest received during the previous year on deposits under the National Deposit Scheme of the Government of India and on any dividend from an Indian company. However, this provision is also dropped w.e.f. the A.Y. 1993-94.

ii) Other points

- a. Deduction under this section is allowed only to an individual, HUF or to an association of persons.
- b. Interest received in respect of compulsory deposits made under the Compulsory Deposits (Income-Tax Payers) Scheme, 1974 is also deemed as interest received from a banking company.

iv) Illustrations

Ramarao submits the following figures for computation of his total income for previous year 1991-92.

	Rs.
Salary (Gross)	65,000
Interest on Government Securities	4,000
Interest on National Deposit Scheme	2,500
Interest on Compulsory Deposit Account	2,100
Dividends (Gross)	4,000
Interest/Dividends from Unit Trust of India	3,400

He donates Rs. 5,000 to an approved agency and pays Rs. 7,000 by way of Life Insurance Premium on his life insurance. Compute his total income.

Solution

	Rs.	Rs.
Salary (Gross)	65,000	
Less: Standard deduction	<u>12,000</u>	53,000
Income from other sources:		
Interest on Securities	4,000	
Interest on National Deposit Scheme	2,500	
Interest on Compulsory deposit	2,100	
Dividends (Gross) from Indian companies	4,000	
Dividends from UTI	<u>3,400</u>	<u>16,000</u>
Gross Total Income		69,000
a. Donation 50% of Rs. 5,000	2,500	
b. Interest etc. under section 80L	7,000	
Addl. deduction for NDS and Dividends	3,000	
Addl. for U.T.I.	<u>3,000</u>	<u>13,000</u>
Total Income		<u>53,500</u>

Note:-Deduction under section 80L for interest etc. has been worked out as under.

Interest on Government securities	4,000
Interest on compulsory deposit	2,100
Dividends	4,000

	10,100

Being restricted to Rs. 7,000

Additional deduction in respect of interest on National Deposit Scheme Account and dividend from Indian companies is also eligible for deduction upto an amount of Rs. 3,000.

In addition, an amount upto Rs. 3,000 is allowable in respect of dividends from Unit Trust of India.

XI) Deduction in respect of royalties, etc., Received from Certain Foreign Companies: Section 80 Q

Deduction under this section is allowed to an Indian company or a person (other than a company) who is resident in India deriving income by way of royalties, commission, fees, etc., from a foreign Government or a Foreign enterprise. It should be in consideration for the use outside India of any patent, model, design, etc., or information concerning industrial, commercial or scientific knowledge made available to such Government or enterprise. The deduction allowed would be equal to 50% of the income received in India. This deduction shall be allowed only in respect of that income; which is received in convertible foreign exchange in India. In addition, such income must be received in India either in the previous year or within a period of 6 months from the end of the previous year or within such extended period granted by the Commissioner.

XII) Deduction in respect of Profits and Gains from the business of Publication of Books: Sec.80 Q

Where the gross total income of an assessee includes any profit and gains from the business of printing/publication of books, there shall be allowed in computing the total income, a deduction of an amount equal to 20 percent of the profits and gains from such business in respect of the income of the previous year relevant to the A.Y. 1992-93 or to any one of the next four assessment years.

XIII) Deduction in respect of Professional Income of Author of Text Books in Indian Languages: Section 80 QQA

With a view to encouraging authors to write standard text books of University level in Hindi and other Indian languages, Section 80 QQA provides for a deduction in computing total income of an author. It will be at 25% of the income from such books. It will be available in respect of any lump-sum consideration for the assignment or grant of any of his interest in the copyright of any such book or of royalties or copyright fees (whether receivable in lumpsum or otherwise). For claiming this deduction the following conditions are to be fulfilled.

- a. The book has been prescribed or recommended as textbook by any university for a degree, postgraduate courses or is a dictionary, thesaurus or encyclopaedia.
- b. The book etc. is in language specified in the Eighth Schedule of the Constitution or in any language as may be notified by the Central Government having regard to the need for publication of such text books in that language.

The deduction will be available from 1992-93 assessment year for a period of five years.

XIV) Deduction in respect of Remuneration from Certain Foreign Sources in the case of Professors, Teachers etc.: Section 80R

Deduction under this section is allowed only in case of professors and teachers who have earned remuneration from abroad during the previous year.

Points for consideration:

- a. The individual must be a citizen of India.
- b. Remuneration must be received from any University or educational institution established outside India or any other association etc.
- c. The individual must have served as professor, teacher or research worker in such University etc.
- d. The amount of deduction will be --
 - a) 50% of such income received by the tax payer, or
 - b) 75% of such income as is brought into India by or on behalf of the tax payer in accordance with FERA 1973; whichever is higher.

XV) Deduction in Respect of Professional Income from Foreign Sources in Certain Cases: Section 80 RR

This Section takes care of the earnings of an author, playwright artist, musician, sportsman or athlete resident in India who derives income in the exercise of his profession from foreign source.

The amount of deduction will be:

- a) 50% of such income received by the tax payer, or
- b) 75% of such income as is brought into India by or on behalf of the tax payer in accordance with the FERA 1973, Whichever is higher.

XVI) Deduction in respect of Remuneration Received for Services Rendered Outside India: Section 80 RRA

Deduction under this section is allowed to an individual who is a citizen of India. It is allowed in respect of any remuneration received in foreign currency from any employer for the services rendered outside India. It is allowed as stated below:

- a. 50 percent of the remuneration, or
- b. 75 percent of such remuneration as is brought into India by or on behalf of the assessee in accordance with the Foreign Exchange Regulation Act, 1973, and any rules made thereunder, whichever is higher.

i) Other Conditions

1. The individual before undertaking such services must have been in the employment of the Central Government or State Government when the service is sponsored by the Central Government.

2. In case of non-government employees or individuals, he must be a technician and conditions of his service outside India must be approved in this behalf by the Central Government or the prescribed authority.
3. He may be under an Indian employer or a foreign employer.

Check Your Progress - I

What are the deductions available under section 80HH, 80HHA and 80HHB ?

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Check Your Progress - 2

Explain in brief the deduction allowed under section 80L.

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18.3 OTHER DEDUCTIONS

Deduction in the case of permanent physical disability (including blindness): Section 80 U

A deduction of Rs. 20,000 will be allowed in computing the total income of an individual who is resident and who at the end of the previous year is suffering from a permanent disability (including total or partial blindness). It is also available to a person who is subject to mental retardation.

The above deduction is allowed subject to the following conditions:

- i) The ailment must have the affect of reducing considerably such individual's capacity for normal work or engaging in a gainful employment or occupation.
- ii) Such person should produce the disability certificate from a physician/surgeon/ oculist/psychiatrist working in a government hospital.

18.4 ILLUSTRATIONS

1. Mr. Manohar requests you to compute his total income for the assessment year 1992-93 from the following:

	Rs.	Rs.
Business Profits		67,000
Interest on bank deposits		23,000
Interest on company deposits		10,000
Winnings from State Lotteries		55,000
Long-term capital gains from sale of jewellery (25 years)		2,00,000

Solution

Business profit			67,000
Long term capital gains	2,00,000		
Less: Deduction u/s 48(2):			
First 15,000 - 100%	15,000		
50% of Rs. 1,85,000	<u>92,500</u>	<u>1,07,500</u>	92,500
Income from other sources:			
Interest on bank deposit	23,000		
Interest on company deposits	10,000		
Winnings from Lotteries	<u>50,000</u>	<u>83,000</u>	
(55,000 - 5,000)			
Gross Total Income			2,42,500
Less: Deduction under 80L in respect of dividends			<u>7,000</u>
Total Income			<u>2,35,500</u>

2. Mr. Lokesh is an assessee for the assessment year 1992-93. The following are the particulars of his income and you are required to compute his total income.

	Rs.	Rs.
Salary (Gross)		75,000
Income from house property (computed)		25,000
Interest on bank deposits		12,000
Casual Income		16,000
Tamil-Nadu Lottery Prize.		80,000

His disbursements are as follows:

Life Insurance Premium	10,000
Donations to National Defence Fund	3,000
Tax Advocate Fee	1,000
Interest on Moneys borrowed for payment of tax	500

Solution	Rs.	Rs.
Salary (Gross)	75,000	
Less: Standard deduction	<u>12,000</u>	63,000
Income from house property		25,000

Income from other sources:

Interest on bank deposits	12,000	
Casual income (16,000-5,000)	11,000	
Lottery Prize	<u>80,000</u>	<u>1,03,000</u>
Gross Total Income		<u>1,91,000</u>

Permissible Deductions:

80 G: Donation 50% of Rs. 3,000	1,500	
80 L: Interest on Bank deposit	<u>7,000</u>	<u>8,500</u>
Total income		<u>1,82,500</u>

Qualifying amount for Rebate of Tax under section 88:Rs. 10,000

18.5 SUMMING UP

Certain deductions are allowed in respect of certain incomes. They pertain to tax holiday in case of newly started industrial undertakings, starting new units in rural areas, income from dividends, interest, long term capital gains, etc. Students are supposed to have a good idea of all such deductions so that they are in a position to compute the tax liability correctly. The deductions are helpful to those who are interested in starting tax consultancy.

The following is the summary of all deductions mentioned in these two units (Units 17 and 18):

Section	Who can claim?	Nature of deduction for the assessment year (1992-93).
80 CCA	Individuals, HUFs and certain AOPs/ BOIs	Deposit in National Savings Scheme (Subject to maximum of Rs.40,000)
80 CCB	Individuals, HUFs and certain AOPs/ BOIs.	The amount invested in Unit linked savings schemes subject to a maximum of Rs.10,000
80 D	Individuals, HUFs and certain AOPs/ BOLs	Medical insurance premia (upto Rs.3,000)
80 DD	Individuals and HUF	Medical expenditure incurred for the treatment of handicapped dependents (Rs.6,000 provided total income does not exceed Rs.one lakh.).

80 G	All assesses	Donation to certain funds, charitable institutions (subject to a maximum of 50 per cent of qualifying donation, 100 per cent qualifying donation for promotion of family planning, donation to the Prime Minister's National Relief Fund, PM's Armenia Earthquake Relief Fund and Africa (Public Contributions - India) Fund.
80 GG	Individuals/HUFs	Rent paid for furnished, or unfurnished residential accommodation subject to a maximum of Rs.12,000.
80 GGA	All assesses not having any income chargeable under the head "Profits and gains of Business or Profession."	Certain donations for scientific research, rural development etc.
80 HH	All assesses	Profits and gains from newly established industrial undertakings or hotel business in backward areas (20 per cent of such profits or gains).
80 HHA	All assesses	Profits and gains from newly established Small Scale Industrial undertakings in certain cases (20 per cent of such profits or gains).
80 HHB	Indian company and a non-corporate resident assessee	Profits and gains from projects out side India (50 per cent).
80 HHC	Indian company and a non-corporate resident assessee	Profits and gains from export turnover (100 per cent of such profit).
80 HHD	Resident taxpayers engaged in the business of hotel/tour operators or travel agent.	Earnings in convertible foreign exchange.
80 HHE	Person resident in India	Profits from export of computer software or providing technical services relating to computer software outside India. (100% of such profits).
80-I	All assesses	Profits and gains from industrial undertakings set up after March 31, 1981 but before

		1.4.91 (25 per cent and 20 per cent of such profits and gains in the case of companies and non-corporate assesses, respectively).
80IA	All assesses	Profits and gains from industrial undertakings etc. in certain cases set up after 31.3.1991. (30% (50% in case of hotel) and 25% of such profits and gains in case of companies and non corporate assesses respectively).
80JJ	All assesses	Profits and gains derived from the business of poultry farming (33 1/3 per cent of such income).
80L	Individuals, HUFs and certain BOIs/AOPs	Interes on certain securities, dividends etc. subject to maximum of Rs.7,000 (additional deduction of Rs.6,000 in some cases).
80 O	Indian companies and non-corporate resident assesseees.	Royalty fees, etc. received from foreign companies (50% of such royalty, fees, etc.).
80 Q	All assesseees	Profits and gains from business of publication of books (20% of such profits and gains).
80QQA	Resident Individuals	Professional income of authors of text books in Indian languages (25% of such income).
80 R	Indian Citizens	Remuneration from certain foreign sources in the case of professors/teachers, etc. (50% of such income or 75% of such income as brought into India as per FERA, w.e. is higher).
80RR	Indian Citizens:	Professional income from foreign sources in certain cases (50% of such income or 75% of such income as brought into India as per FERA, w.e. is higher).
80	RRA Indian Citizens	Remuneration received for services rendered outside India (50% of such income or 75% of such income as brought into India as per FERA, w.e. is higher).

18.6 CHECK YOUR PROGRESS: MODEL ANSWERS

1.
 - i) Under section 80HH deduction in respect of profits and gains from newly established industrial undertakings or hotel business in backward areas is allowed from gross total income to the extent of 20% of such profits or gains.
 - ii) Under section 88HHA, deduction of 20 percent of profits and gains from newly established small scale industrial undertakings in certain areas.
 - iii) Under section 80HHB, deduction in respect of income from projects outside India at the rate of 50 per cent is allowed.
2. Under Section 80L, deduction in respect of dividend, interest and other such incomes is allowed from Gross Total income.

The rate of deduction is:

A deduction in respect of these incomes is allowable subject to a maximum limit of Rs. 7,000.

An additional deduction of Rs. 3,000 in respect of interest units of UTI and NDS and Rs. 3,000 in respect of interest on deposits in NDS and any dividend from an Indian Company.

18.7 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following essay questions in about 30 lines each.

1. Explain and illustrate the provisions relating to tax holiday.
2. Explain the following deductions:
 - a) Royalty income for writing text books in Indian languages.
 - b) Remuneration from abroad in the hands of technicians.

II. Short Questions

Answer the following short questions in about 15 lines each

1. Enumerate deductions allowable in respect of certain incomes.
2. Summarise provisions relating to the deduction in respect of profits and gains from newly established industrial undertakings in backward areas.
3. Discuss the deduction in respect of profits and gains from newly established small scale industrial undertakings in certain areas.
4. What type of deduction is allowed in respect of export turnover?
5. Explain the deduction in relation to bank interest and dividends, etc.

BRAOU

BLOCK - V

COMPUTATION OF TOTAL INCOME AND TAX

This block presents computation of total income and tax relating to individual assesseees. Three units are included in this block. The first two units cover computation of income of individuals and tax respectively, whereas the last unit gives a number of problems covering various provisions on the computation of total income of individuals.

- Unit - 19** : **Computation of Total Income of Individuals**
- Unit - 20** : **Computation of Tax**
- Unit - 21** : **Revisionary Problems**

BRAOU

UNIT-19: COMPUTATION OF TOTAL INCOME OF INDIVIDUALS

Contents

- 19.0 Aims and Objectives
- 19.1 Introduction
- 19.2 Income of an Individual in various capacities
- 19.3 Determination of Taxable Income
- 19.4 Illustrations
- 19.5 Summing Up
- 19.6 Check Your Progress: Model Answers
- 19.7 Model Examination Questions

19.0 AIMS AND OBJECTIVES

The objective of this unit is to present a few problems on the computation of total income of Individuals.

After going through the unit, you will be able to:

- * Solve numerical problems on the computation of total income of individuals.

19.1 INTRODUCTION

We have already discussed the method of calculating taxable income under different heads. Provisions regarding clubbing of income have also been explained. In addition we will take care of the set off and carry forward and set off of losses. The resultant figure will then be the gross total income. Out of gross total income are deducted a few amounts with a view to finding out the total income. In this unit all that will be put to test when you would be asked to compute total income giving numerical illustrations.

19.2 INCOME OF AN INDIVIDUAL IN VARIOUS CAPACITIES

For the sake of clarity we will discuss below how an individual is taxed in various capacities.

i) Member of HUF

Whatever amount is received by an individual as a member of the HUF will not be included in total income. It is not necessary that the HUF must have paid tax before the member thereof claims tax exemption cited above.

ii) As a Member of an Unregistered Firm or Association of Persons

Share from an unregistered firm is included in the hands of individual assessee. In case the unregistered firm has paid income-tax on its total income, his share in his hands will be eligible for rebate of income-tax at average rate. In case the firm has not paid tax on its income

being less than the taxable limit, the individual assessee will not claim any rebate in respect of share of profit from unregistered firm. The same provision applies in respect of Association of persons.

iii) As a Member of a Registered Firm

Share of profit from a registered firm is included in total income of the individual assessee and taxed like any other income.

iv) As a Member of a Company

An individual assessee can also be a shareholder of a company in which capacity he will be entitled to dividend in respect of his holding. Whatever dividend he receives from the company is taxable in his hands.

There is a possibility of an individual assessee getting amounts from firm and the company as well as the HUF. In that case we will include all that amount in his gross total income. The problems given in this unit are based on whatever provisions we have discussed in the earlier units.

19.2 DETERMINATION OF TAXABLE INCOME

While determining the taxable income, the following are the steps to be followed:

- i) First, ascertain gross total income ignoring income exempted under Sec. 10, if any. Income under different heads is to be added for this purpose.
- ii) Second, deduct admissible deductions under chapter VI A of the Income-Tax Act. The following deductions are available to an individual for the AY 1992-93.

Section	Nature of deduction
80 CCA	National Savings Scheme
80 CCB	Unit Linked Savings Scheme
80D	Payment for medical insurance premia
80DD	Medical treatment for dependent handicapped person
80G	Donations to charitable institutions and funds
80GG	Rent paid
80GGA	Donations for scientific research or rural development
80HH	Profits and gains from new industrial undertakings or hotels set up in certain backward areas.
80HHA	Profits and gains from new small-scale industries set up in certain rural areas.
80HHB	Profits and gains from projects outside India
80HHC	Profits and gains from export turnover
80HHD	Earnings in convertible foreign exchange in certain cases

80HHE	Profits from export of computer software setup before 1-4-91
80I	Profits and gains from industrial undertakings, etc.
80IA	Profits and gains from Industrial under taking, etc., set up after 31-3-91.
80JJ	Profits and gains from poultry farming
80L	Interest on certain securities, dividends, etc.
80O	Royalties, fees, etc., received from certain foreign companies.
80Q	Profits and gains from business of publication of books.
80QQA	Professional income of authors of text-books in Indian languages
80R	Remuneration received by teachers and professors from foreign services
80RR	Professional income from foreign sources
80RRA	Remuneration received from services rendered outside India
80U	Income of blind and handicapped persons

Check Your Progress - I

What are the steps involved in determining the taxable income?

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19.4 ILLUSTRATIONS

1. Shri Prem Prakash furnishes the following particulars relating to his income. He is an employee of a Private Limited Company at Madras.
 - a) Salary Rs. 2,000 per month
 - b) Bonus equal to 2 months salary.
 - c) Dearness Allowance at 20% of the basic salary
 - d) He contributes 15% of his salary to Recognised Provident Fund to which his employer contributes equal amount.
 - e) Interest credited to Provident Fund account at 11% per annum for the previous year amounted to Rs. 1,100.
 - f) He is given rent-free furnished quarter owned by employer which has a municipal value of Rs. 500 per month and cost of the furniture amounts to Rs. 10,000.
 - g) Employer has given him a car with 14 H.P. which he uses for both private and official purposes, expenses for the private being met by Sri Prem Prakash himself.

- h) The company pays his Life Insurance Premium of Rs. 6,000, the policy amount being Rs. 50,000 and he pays Rs. 1,000 Insurance Premium on the life of his wife, the assured sum being Rs. 8,000.
- i) He is offered free services of a gardener and of a servant whose monthly salaries amounted to Rs. 100 and Rs. 80 respectively, Compute his Total income for the previous year 1991-92.

Solution

	Rs.
Basic Salary at Rs. 2,000 per month	24,000
Bonus 2 months salary	4,000
Dearness allowance at 20%	4,800
Employer's contribution to R.P.F. in excess over 10%	1,200
Rent free house	3,800
Use of free car	1,200
Life Insurance premium paid by the company	6,000
Free servant at Rs. 80 per month	960
Gross Salary	45,960
Standard deduction	12,000
Net salary being gross total income/Taxable Income	33,960

Qualifying Amount for Rebate of Tax U/S 88

Contribution to R.P.F.	3,600
Life Insurance paid by Co.	5,000
Premium paid by the assessee	800
	9,400

NOTES

- Employer's contribution to Recognised Provident Fund is tax free upto 10% of salary Excess over 10 percent is included in salary and taxed.
- Rent free house has been valued as under:

	Rs.
Salary plus Bonus (24,000+4,000)	28,000
10% of salary and bonus	2,800

Excess of rental value (Rs.6,000+1,200)
over 60% of Salary and bonus (16,800)

Nil
2,800

10% for furniture

1,000

Taxable Value of furnished home

3,800

2. Dilip received the following incomes during the year ended 31st March 1992.

	Rs.
a) Salary from his employer at Rs. 3,000 per month	36,000
b) Leave Travel concession for proceeding on leave to home-town in India	4,000
c) Lunch Allowance at Rs. 250 per month	3,000
d) Reimbursement of medical expenses from employer	4,300

Dilip also enjoyed the following other benefits and perquisites:

- Rent-free flat in Bombay for which his employer pays a rent of Rs. 1,200 per month.
- Free gas and electricity for which employer paid total bills of Rs. 1,700.
- One free car of 14 H.P. with driver for personal use and official purposes.

Dilip had certain investments in shares on which he earned dividend of Rs. 8,000. Out of this, however only Rs. 6,300 was received in hand after deducting tax at source of Rs. 1,600 and bank commission of Rs. 100 for realising the dividend.

Compute the gross total income of Mr. Dilip for the assessment year 1992-93.

Solution	Rs.	Rs.
Basic at Rs. 3,000 p.m.		36,000
Lunch allowance at Rs. 250 p.m.		3,000
Rent Free Flat at Bombay		4,070
Free Gas and Electricity Bills paid by employer		1,700
Free use of Car (450 X 12)		5,400
		<u>50,170</u>
Gross Salary		50,170
Less: Standard Deduction		12,000
		<u>38,170</u>
Income from other Sources:		
Dividend		8,000
Less: Collection Charges		<u>100</u>
		<u>7,900</u>

Gross Total Income	46,070
Less: Deduction u/s 80L	7,900
Total Income	<u>38,170</u>

NOTES

1. Leave Travel Concession is not taxed assuming that the conditions for such exemptions have been complied with.
2. Reimbursement of medical expenses is not taxed assuming that all the relevant conditions are satisfied.
3. Salary is taxable on accrual basis.
4. Valuation of Rent-free flat at Bombay:

FRV of the flat is Rs.	<u>14,400</u>
10% of Salary	4,070
Add: FRV - 60% of Salary	Nil
	<u>4,070</u>

Salary for this purpose is Rs.40,700 (i.e. 36,000 + 3,000 + 1,700). Gas, electricity and water bills paid by employer also form part of "Salary" for this purpose.

4. It is assumed that the dividend is from Indian Company.
3. Following are the particulars of income of M. Tushar, Manager of a limited company for the year ended 31st March, 1992.
 1. Salary Rs. 2,500 p.m. from which 10% is deducted as contribution to an Unrecognised Provident Fund, the company contributing the same amount.
 2. Conveyance allowance received from the company is Rs. 250 p.m. but he has not spent any amount of this.
 3. Rent-free house has been provided by the company whose annual letting value is Rs. 3,000.
 4. 6% dividend is declared by the company on 500 shares of Rs. 100 each held by him.
 5. He withdrew from the Company Rs. 3,500 as travelling allowance out of which he actually spent Rs. 1,500.
 6. His son is studying in a college and the company pays Rs. 400 p.m. towards the cost of his education.
 7. During the year, he paid Rs. 4,500 as Life Insurance Premium.
 8. He deposited Rs. 5,000 in a 10 year Cumulative Time Deposit Account in a post office and Rs. 3,000 in a public provident fund.

You are required to compute his total income for the assessment year 1992-93.

Solution

	Rs.
Salary at Rs. 2,500 per month	30,000
Conveyance allowance not spent at Rs. 250 p.m.	3,000
Unspent travelling allowance (3,500-1,500)	2,000
Education expenses of his son met by the company	4,800
Rent-free accommodation	<u>3,000</u>
Gross Salary	42,800
Standard deduction	<u>12,000</u>
Taxable Salary	30,800
Income from other sources (Dividends Grossed)	<u>3,000</u>
Gross Total Income	33,800
Permissible Deductions:	
u/s.80L:Dividends	<u>3,000</u>
Total Income	<u>30,800</u>

Qualifying Amount: u/s 88 for Rebate of Tax**Qualifying Amount:**

a.	Life Insurance Premium	4,500
b.	10 year Cumulative Time Deposit	5,000
c.	Public Provident Fund	3,000
		<u>12,500</u>

4. The following is the Income and Expenditure Account of a Medical Practitioner for the previous year ending 31st March 1992.

Expenditure		Income	
Salary to Staff	12,000	Consultation Fees	41,100
Laboratory expenses	6,000	Visiting fees	10,000
Rent of dispensary	6,000	Gift from patient	4,000
Purchase of medicine	4,500	Sale of medicine	8,000

Income tax	3,500	Rent from house property	12,000
Car expenses	3,640	Interest on debentures (Net)	900
Membership fees	200		
Municipal tax(on house)	1,200		
Repairs	1,800		
Printing charges	400		
Charity	150		
Sundry expenses	750		
Surplus for the year	35,860		
	<u>76,000</u>		<u>76,000</u>

Compute his total income for the Assessment Year 1992-93 after taking into consideration of the following information:

- Gift includes Rs. 1,000 received from his relatives in personal capacity.
- There was no stock of Medicines
- The car was used entirely for the profession
- Repairs related to house property.
- He paid insurance premium of Rs. 8,000 on his life policy of Rs. 80,000
- Depreciation on surgical equipment and furniture amounted to Rs. 4,500 allowable as deduction as per rule.
- Debentures are listed in recognised stock-exchange.

Solution

Income from House Property

	Rs.	Rs.
Rent received	12,000	
Municipal taxes	<u>1,200</u>	
Annual Value	10,800	
Less: repair allowance	<u>1,800</u>	<u>9,000</u>

Profits and gains from Profession

RECEIPTS

Consultation Fee	41,100
Visiting Fee	10,000

Gifts from patients	3,000	
Sale of medicines	<u>8,000</u>	62,100

EXPENSES

Salaries	12,000	
Laboratory expenses	6,000	
Rent of dispensary	6,000	
Purchase of medicines	4,500	
Car expenses	3,640	
Membership fees	200	
Printing charges	400	
Sundry expenses	750	
Depreciation Allowance	<u>4,500</u>	37,990

Income from Profession	<u>24,110</u>
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Income from Other Sources

Interest on debentures (net) Rs. 900

Gross interest $900 \times 100 / 88.8$	<u>1,014</u>
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Computation of Total Income:

i) Income from House Property	9,000
ii) Income from profession	24,110
iii) Income from other sources	<u>1,014</u>

Taxable Income	<u>34,124</u>
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Qualifying Amount u/s 88-- Rs.8,000

NOTE

1. Tax is deducted at source at 11.2% where the debentures are listed in a recognised stock exchange.
2. Gifts excluding those received from relatives in personal capacity will be included in professional income.

5. Shri Enterprise owned by Krishna has prepared the following statement for the year ending on 31-3-1992:

PROFIT AND LOSS ACCOUNT

	Rs.		Rs.
Salary to proprietor	12,000	Gross Profit b/d	50,000
Office staff salary	15,000	Bad debts recovered	5,000
General expenses	5,000	Interest on Govt. Securities	3,500
Interest on capital	2,000	Dividend on shares	18,500
Bad debts	1,000	Interest on Public Provident Fund	2,000
Advertisement	2,700	Interest on Post Office Deposit (10 years)	3,000
Fire Insurance	1,000		
Depreciation	4,000		
Provision of bad Debts	2,000		
Income-tax (1990-91)	3,000		
Advance Income-tax	2,000		
Donation to Prime Minister's Drought Relief Fund	2,000		
Car expenses	1,000		
Net Profit	29,300		
	<u>82,000</u>		<u>82,000</u>

Additional Information

- a. Depreciation allowed as per I.T. Act. Rs. 3,600 only.
- b. General expenses include Rs. 500 spent on printing calenders and diaries
- c. Advertisement includes cost of New Sign Board Rs. 1,400.
- d. Of the bad debts recovered, the AO had disallowed Rs. 2,000 only in the concerned assessment year.
- e. Car is used for business as well as for private purposes equally.

Compute his total income for the Assessment year 1992-93.

Solution

Computation of Total Income of Mr. Krishna for the Assessment Year 1992-93.

I. Income from Business

	Rs.	Rs.
Net Profit as per Profit and Loss Account		29,300
Add. Inadmissible items:		
Salary to Proprietor	12,000	
Interest on Capital	2,000	
Depreciation (4,000-3,600)	400	
Provision for bad debts	2,000	
Income-tax	3,000	
Advance Income-tax	2,000	
Donation to Prime Minister's Drought Relief Fund	2,000	
Advertisement (cost of new sign board)	1,400	
Car expenses 50%	500	25,300
		54,600
Less: Incomes to be shown separately:		
Bad debts recovered	2,000	
Interest on Government Securities	3,500	
Dividend on Shares	18,500	
Interest on R.P.F.	2,000	
Interest on Post Office Deposits	3,000	29,000
Income from Business		25,600

II. Income from Other Sources

Dividend on Shares	18,500
Interest on P.O. Deposits	3,000
Interest on Government Securities	3,500
	25,000

Less: admissible expenses

25,000

Computation of Total Income of Mr. Krishna for the Assessment Year 1992-93.

	Rs.	Rs.
I. Income from Business		25,600
II. Income from other sources		<u>25,000</u>
Gross Total Income		50,600
Deduction u/s. 80L:	9,000	
Deduction u/s 80G	<u>1,000</u>	<u>10,000</u>
Total Taxable Income		<u>40,600</u>

NOTES

1. Cost of new sign board is capital expenditure.
2. Interest on Public Provident Fund is exempted
3. Bad debts disallowed in earlier years, if recovered are not put to tax.
4. Expenses on printing calendars and diaries Rs. 500 is allowed.
5. It is assumed that dividend on shares is from Indian companies.
6. From the following particulars of Mr. A for the previous year ended 31-3-1992 compute his total income:

	Rs.
Dividend on preference shares (Gross)	1,000
Income from sub-letting of building and Machinery on hire	12,000
Interest on Bank deposits	2,500
Director's sitting fees received	1,200
Income from undisclosed sources	10,000
Winning from Lotteries	20,000
Collection charges of Dividend	30
Rent paid on Building and Machinery	4,000
Repairs to the Machine as per agreement	100

Solution**Computation of Total Income of Mr. 'A' for the A.Y. 1992-93.**

	Rs.	Rs.	
Dividend on Preference Shares		1,000	
Less: Collection Charges		<u>30</u>	970
Income from sub-letting of Building and Machinery		12,000	
Less: Rent paid	4,000		
Repairs to Machinery	<u>100</u>	<u>4,100</u>	7,900
Interest on Bank deposits			2,500
Directors sitting fees received			1,200
Income from undisclosed sources			10,000
Winning from lotteries(20,000-5,000)			<u>15,000</u>
Gross Total Income			37,570
Deduction under section 80L:			<u>3,470</u>
Total Taxable Income			<u>34,100</u>

7. From the following particulars, compute the total income of Shri Nand Kumar, Bangalore:

1. Salary Rs. 12,000 p.a. Annual Bonus at 20% of Salary, Conveyance Allowance of Rs. 1,200 p.a. House rent allowance Rs. 250 p.m. (he lives in house paying a rent of Rs.300 p.m). He paid Rs. 400 as a donation to a recognised school. He and his employer contributed 15% of salary each towards Recognised Provident Fund. Interest credited to R.P.F is Rs.1,200 at 10%. He pays Rs. 1,000 as L.I.C premium.
2. His Investments are:
 - a. Rs. 15,000 in 10 percent Preference Shares of a company.
 - b. Rs. 4,000 in 4 percent Mysore Government Loan.
 - c. Rs. 12,000 in 6 percent Mangalore Port Trust debentures.
 - d. Rs. 15,000 in 12 percent debentures of Raymond Woollens Ltd.

His banker charged Rs. 40 as commission to buy and sell these securities during the year, and Rs. 10 for collecting interest and dividends.

3. He sold a machinery yielding a capital gain of Rs. 10,000 and a building in which the capital gain was Rs. 15,000(the second one is long term for 15 years)
4. He won a prize money in crossword puzzle Rs. 500.

Compute the total income for the assessment year 1992-93.

Solution

Computation of Total Income of Shri Nanda Kumar for A.Y. 1992-93:

I. Income from Salary:

Salary	12,000	
Bonus 50%	2,400	
House rent allowance	3,000	
Less exempted	<u>2,400</u>	600
Excess of contribution to R.P.F by employer		600
		<u>15,600</u>
Less standard deduction at $33\frac{1}{3}\%$	<u>5,200</u>	<u>10,400</u>

II. Income from capital gains:

Long term capital gain on sale of building	15,000	
Less deduction u/s 48 (2)		
First 15,000 100%	<u>15,000</u>	Nil
Short term capital gain on Sale of machinery		<u>10,000</u>

III. Income from other sources:

Dividend on preference Shares	1,500	
Interest on securities		
4,000 in 4% Mysore Govt. Loan	160	
12,000 in 6% Mangalore Port Trust debentures	720	
15,000 in 12% Raymonds Ltd. debentures	<u>1,800</u>	
	4,180	
Less Collection Charges	<u>10</u>	4,170
Income from crossword puzzle (500-500)	<u>—</u>	<u>4,170</u>

Computation of Total Income

i) Salary income	10,400
ii) Capital Gains	10,000
iii) Income from other sources	<u>4,170</u>
	24,570

Deductions

Under Section 80 G

200

Total Income 24,370

NOTES

1. Conveyance allowance received by Mr. Kumar has been assumed to have been spent.
2. Calculation of H.R.A.: least of the following is exempted.
 - a) 40% of salary 4,800
 - b) Excess of Rent paid over 10% of salary (3,600-1,200) 2,400
 - c) Actual H.R.A. received 3,000
3. Calculation of Qualifying amount for Section 88:
 - a) Contribution to R.P.F. 1,800
 - b) L.I.C. Premium 1,000

2,800
4. 50% of Donations are allowed.
5. Commission paid to Banker Rs. 40 towards purchase and sale of securities is not allowed.
6. Prize money won on crossword puzzle Rs. 500 is exempted as it is casual income and is less than Rs. 5,000.
8. From the following Profit and Loss Account ascertain the taxable income of Mr. Reddy for the assessment year 1992-93.

	Rs.		Rs.
Office expenses	5,720	Gross Profit	27,635
Sundry expenses	2,640	Interest on Govt. securities	1,660
Interest on Capital	1,580	Commission	365
Reserve for bad debts	835	Bad debts Recovered	640
Audit Fees	300	Profits on sale of securities	850
Rent of shop	1,255	Miscellaneous receipts	250
Income-tax	1,730		
Charity and donation	485		
Legal charges	400		

Compensation to workmen	1,000	
Fire Insurance	2,000	
Net Profit	13,455	
	<u>31,400</u>	<u>31,400</u>

- Sundry Expenses include Rs. 250 for furniture purchased.
- Depreciation allowance admissible according to rules is Rs. 1,400
- Charity and donations include Rs. 300 donated to Congress Party.
- He owns a house, half of which is occupied by him for his own residence and the other half is let out at a monthly rent of Rs. 200. He pays Rs. 300 as municipal taxes and Rs. 400 for fire insurance premium in respect of the house. During the previous year he spent Rs. 900 for white washing and repairs of the house.

Solution

I. Income from Business:	Rs.	Rs.
Net Profit as per P&L Account		13,455
Add Inadmissible expenses:		
Sundry expenses	250	
Interest on capital	1,580	
Reserve for Bad debts	835	
Income tax	1,730	
Charity and Donations	<u>485</u>	
		4,880
		<u>18,335</u>
Less: Depreciation Allowance		1,400
		<u>16,935</u>
Less: incomes to be shown separately:		
Interest on Govt. Securities	1,660	
Profit on sale of Securities	850	2,510
	<u>2,510</u>	<u>14,425</u>
II. Income from House Property		
a. Let out House Rental Value	2,400	
Less: municipal Tax	150	
Annual Value	<u>2,250</u>	

DEDUCTIONS

1/6 repairs	375		
Fire Insurance	<u>200</u>	<u>575</u>	1,675
b. Self Occupied House		Nil	1,675
III. Income from capital Gains Profit On sale of Securities			850
IV. Income from other Sources:			
Interest on Government securities			<u>1,660</u>
Gross Total Income			18,610
Deduction under Section 80L			<u>1,660</u>
Taxable Income			<u>16,950</u>

NOTES

- Charity and donations do not qualify for deduction.
- It is assumed that profit on sale of securities is short term in nature.
- Mr. Chopra draws a salary of Rs. 1,000 P.M. He owns two houses, one whose municipal valuation is Rs. 3,000 is occupied by him for his own residence and the other, whose municipal valuation is Rs. 25,000 is let out at Rs. 250 p.m. The expenses in respect of both the houses are:

	1st House (occupied for own residence)	2nd House (Let out)
	Rs.	Rs.
Municipal Tax	300	300
Land revenue	150	200
Interest on loan for recons- tructing the house	300	400
Fire Insurance Premium	200	200
Interest on Mortgage	--	500
Rent collection charges	--	200

The 2nd house remained vacant for two months. His income from dividends during the previous year 1991-92 was Rs. 5,200.

Calculate his total Income.

Solution

Computation of Total Income of Mr. Chopra for the Assessment Year (A.Y.) 1992-93.

I.	Income from Salary	Rs.	Rs.
	Salary 1,000 X 12	12,000	
	Less Standard deduction	<u>4,000</u>	8,000
	at 33 1/3%		
II.	Income from house Property:		
a.	Let Out Property:		
	Rental Value (250X12)	3,000	
	Less Municipal Tax	<u>300</u>	
	Annual Value	2,700	

DEDUCTIONS

	1/6 Repairs	450		
	Land Revenue	200		
	Interest on Loan	400		
	Fire Insurance	200		
	Vacancy allowance (2,700 X 2/12)	450		
	Collection charges restricted to 6% of annual value	<u>162</u>	<u>1,862</u>	838
b)	Self Occupied House:			
	Annual Value	Nil		
	Less interest on Loan	<u>-300</u>	-300	538
III.	Income from other sources:			
	Dividend received		<u>5,200</u>	
	Gross Total Income		13,738	
	Deduction u/s. 80L		<u>5,200</u>	
	Total Income		<u>8,538</u>	

NOTES

Interest on mortgage is not an allowable expense where the money has been used for purposes other than construction/repairs of the house property.

10. Calculate the net salary income of Mr. D.G. Prakasham, an Accountant in a Public Limited Company whose particulars are given below:

- a. Salary per month Rs. 1,000.
- b. City Compensatory allowance Rs. 100 p.m.
- c. Bonus at 8.33% of basic salary and C.C.A.
- d. Employer's contribution to recognised provident fund at 15% of basic salary and his own contribution is also 15%.
- e. Rent-free furnished house for which the Company pays Rs. 3,000 per month, furniture of the depreciated value of Rs. 8,000, the original cost being Rs. 12,000.
- f. Free use of 12 H.P. motor car for personal purpose, the expenses being paid by the employee.
- g. Free services of a gardener and a watchman at Rs. 100 and Rs. 80 p.m. respectively.
- h. Education allowance to two children at Rs. 100 per child p.m.
- i. Rs. 2,000 paid towards Life Insurance Premium on the policy of his wife.
- j. Received Rs. 6,500 as interest on deposits in a Nationalised Bank.

Solution

Computation of Total Income of Mr. D.G. Prakasham for the A.Y. 1992-93

	Rs.	Rs.	Rs.
1. Income from Salary			
Salary 1,000 X 12		12,000	
C.C.A. 100 X 12		1,200	
Bonus		1,100	
Excess of Employer's contribution to R.P.F.		600	
Education allowance		1,200	
Rent Free Accommodation:			
10% of Salary 15,500	1,550		
(12,000+1,200+1,100+1,200)			
Excess of Fair rental value over 50% of salary	Nil		
	1,550		
Add 10% on the cost of furniture	1,200	2,750	
		18,850	
Less standard deduction $33\frac{1}{3}\%$		6,283	12,567

II. Income from other Sources:

Interest on Bank deposits

6,500

Gross Total Income

19,067

Deductions:

Under section 80L

6,500

6,500

Total Income

12,567

NOTES

1. As the assessee's total monetary emoluments do not exceed Rs. 24,000, he is not a specified assessee. Hence the following are not taxable (a) Free Car (b) Free services of gardener and Watchmen.
2. Calculation of qualifying amount for Rebate of Tax under section 88 is as follows:
 - a. Contribution to R.P.F. at 15% 1,800
 - b. L.I.C. Premium 2,000

3,800
3. Calculation of Bonus:

Salary 12,000

C.C.A. 1,200

$13,200 \times \frac{8.33}{100} = 1,100$ (approx.)
4. Education allowance is exempted from tax @ Rs. 50 per child p.m. upto a maximum of two children.
11. Sunil Kumar is Sales Executive in a company with Head Quarters at Bangalore. He furnished the following information for the previous year ending 31st March, 1992 for calculation of his taxable income.
 - a. Salary Rs. 3,500 per month.
 - b. Entertainment allowance Rs. 600 p.m.
 - c. Bonus equal to two months salary
 - d. Commission on sales at 2.5% of Rs. 8,00,000.
 - e. His contribution to recognised provident fund is at 15% with an equal contribution from his employer.
 - f. Interest credited to the provident fund is at 10% and amounts to Rs. 8,800.
 - g. Unfurnished rent-free house has been provided to him with fair rental value of Rs. 12,000.

- h. Medical bills reimbursed amounted to Rs. 4,500.
- i. Club bills of Rs. 2,500 were paid by the employer.
- j. Two motor cars were at his disposal for official and private purpose. They are Indian make cars of less than 16 H.P.

Solution

Computation of Total Income of Sunit Kumar for the A.Y. 1992-93.

	Rs.
I. Income from Salary:	
Salary 3,500 X 12	42,000
Entertainment allowance 600 X 12	7,200
Bonus 3,500 X 2	7,000
Commission (8,00,000 x 2.5 / 100)	20,000
Excess contribution by employer to R.P.F.	3,100
Club bills paid by employer	2,000
Car (300x12)	3,600
Driver's Salary (150x12)	1,800
Rent Free Accommodation	Rs.
10% of Salary	7,620
(42,000+7,000+7,200+20,000)	
Excess of F.R.V. over 50% of Salary	--
	7,620
	94,320
Less Standard Deduction $33\frac{1}{3}$ %	12,000
Total Income	82,320
Qualifying amount under Section 88:	<u>6,300</u>

NOTES

1. Reimbursement of Medical bills is exempted upto Rs. 5,000.
2. Interest credited upto 12% of R.P.F. is exempted.
3. Assumed that Driver is provided to the car.
4. Qualifying amount under section 88 is 15 percent of Rs. 42,000=6,300

12. Shri Srinivas has furnished the following particulars of his income for the year ending 31st March 1992:

- a) Salary Rs. 1,800 per month.
- b) Dearness allowance Rs. 350 per month.
- c) Bonus: Two months salary
- d) He is a member of recognised provident fund and contributes 12 percent of salary thereto with an equal contribution by the employer. During the year interest of Rs. 2,400 at 10 percent has been credited to the fund.
- e) The employer provided him with a 20 H.P. car for office as well as private use bearing all expenses.
- f) The employer has provided him a rent-free house of the annual value of Rs. 6,000. Furniture costing Rs. 10,000 has also been provided therein.
- g) Interest on debentures of cooperative society Rs. 1,800.
- h) Income from dividends of Unit Trust of India Rs. 2,600.
- i) Royalty received in respect of a book on Accountancy Rs. 10,000. He claims Rs. 3,000 as an expenditure in preparing the manuscript of the book.
- j) He donated Rs. 6,000 to Prime Minister's National Defence Fund.
- k) He is insured for Rs. 40,000 on which he pays an annual premium of Rs. 5,000.

You are required to compute Shri Srinivas's total income for the Assessment year 1992-93.

Solution

Computation of Total Income of Shri Srinivas for the A.Y. 1992-93.

I. Income from Salary		
Salary	1,800 x 12	21,600
D.A.	350 x 12	4,200
Bonus	1,800 x 2	3,600
Excess of employer's contribution to RPF		432
Car expenses	400 x 12	4,800
Rent Free Accommodation		
10% of Salary	2,520	
(21,600 + 3,600)		
Excess of F.R.V. over 50% of salary	—	
	2,520	
Add. 10% of cost of furniture	1,000	
		3,520
		38,152
Less standard deduction		12,000
		26,152

II. Income from other Sources:

Interest on Debentures of Co-op.society 1,800

Income from dividends U.T.I. 2,600

Royalty Received 10,000

Less: Expenses 3,000 7,000 11,400

Gross Total Income 37,552

DEDUCTIONS

Under section 80G:

50% of Donations 3,000

Under Section 80L 4,400 7,400

Taxable Income 30,152

NOTES

1. Interest credited to R.P.F. is exempted upto 12 percent.

2. Qualifying amount u/s 88:

1) L.I.C. Premium restricted to 10% of sum assured 4,000

2) Contribution to R.P.F. 2,592

6,592

19.5 SUMMING UP

This unit has dealt with the assessment of individuals. Individuals may derive income from various sources. Similarly, he may derive incomes in various capacities. All such provisions have been discussed earlier in relevant units. Assessee is able to reduce his tax liability by managing his affairs in a way that the maximum deductions could be claimed in computing total income. A few numerical problems on the computation of total income are illustrated in this unit.

19.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) Ascertain taxable incomes under different heads.
- ii) Add: incomes ascertained under different heads.
- iii) Deduct admissible deductions. The resultant amount is the total income..

19.7 MODEL EXAMINATION QUESTIONS

1. Solve the following numerical problems giving suitable notes and necessary workings:

1. Shri Ajit is a manager of X Co.Ltd. He furnished the following particulars of his income for the previous year 1991-92.

	Rs.
1. Basic Salary	36,000
2. Dearness allowance	6,000
3. Bonus	5,000
4. His contribution to a Recognised Provident Fund	4,000
5. His employer's contribution to the Fund	4,000
6. Interest credited to the accumulated balance of the provident fund at 10%	3,000
7. He was provided with a small car which he used both for official and private purposes	
8. He incurred expenditure on Books and newspapers	400
9. He received interest on listed commercial securities (Net)	3,600
10. He received dividend from a Co-op. Society (Gross)	470
11. He paid LIC premium of Rs. 1,000 p.m. on his life insurance for Rs. 1,50,000	
12. He donated to an approved institution	8,000

Compute his total income for A.Y. 1992-93

2. The following investments were held by Shri Mallinath during the previous year 1991-92.

1. Rs. 50,000 6% Tax Free Central Government Securities
2. Rs. 40,000 8% Port Trust Debentures
3. Rs. 30,000 15% Debentures of Paper Mills Ltd.
4. Rs. 20,000 $7\frac{1}{2}$ % Municipal Debentures
5. Rs. 25,000 10% Post Office Cash Certificates.
6. Rs. 30,000 15% preference Shares of 'A' Co.Ltd.
7. Rs. 20,000 9% Karnataka State Government Loan.

On 1-5-1988 Shri Mallinath sold the above Municipal debentures for Rs. 24,000 and on the same day he purchased for Rs. 24,000 10% debentures of Cotton Mills Ltd.

Shri Mallinath paid Rs. 150 as commission for collecting the interest and Rs. 4,000 as interest on the loan taken for purchasing the 6% Tax Free Central Government Securities. The interest on the above securities is payable half-yearly on 1st July and 1st January each year.

Compute his income from other sources for the A.Y. 1992-93.

3. Shri Sandeep is a registered medical practitioner. He has prepared the following Income and Expenditure Account for the year ending 31st March, 1992. You are required to find out his taxable income for the assessment year 1992-93.

Income and Expenditure Account

Expenditure	Rs.	Income	Rs.
Household expenses	8,000	Consultation Fees	7,500
Municipal Tax	800	Visiting fees	12,500
(House Property)		Sale of Medicine	15,000
Repairs of house property	600	Rent from	
Establishment expenses	4,000	House property	9,800
Surgical Equipment	1,500		
Books	250		
Income-tax	1,000		
Car expenses	2,000		
Fire Insurance on house	500		
Property			
Life Insurance premium on own Life	1,800		
Surplus	24,350		
	<u>44,800</u>		<u>44,800</u>

Depreciation allowable on Car Rs. 1,500 and on Surgical equipment 15 percent. One half of car expenses are for personal purposes. Establishment expenses include Rs. 400 being cost of a cycle purchased.

4. Shri Sankar purchases a house property for Rs. 1,20,000 on 10-4-1984. He sold it on 30-4-1991 for Rs. 1,90,000. He incurred an expenditure of Rs. 20,000 on its development and Rs. 5,000 being 40% of the total expenditure in connection with the sale of the house and the remaining expenditure was borne by the purchaser. His income from other sources is Rs. 18,000. Compute his total income for A.Y. 1992-93.

11. Attempting the following short questions in about 15 lines each

1. What are the suitable heads of income under which you will charge the following:
 - a. Remuneration from examination
 - b. Dividends on equity shares.
 - c. Dividends on preference shares
 - d. Interest on Bank deposits
 - e. Interest on debentures
 - f. Income from sub-letting.
 - g. Agricultural income from Nepal
2. How do you allow deductions for long term capital gains?
3. How much deduction is available in respect of dividends, interest on bank deposits and dividend from Unit Trust of India?
4. How do you treat share of profit from registered firm in the hands of partner?
5. Explain taxability of speculation profits.

UNIT-20: COMPUTATION OF TAX

Contents

- 20.0 Aims and Objectives
- 20.1 Introduction
- 20.2 Tax Rebate u/s 88
- 20.3 Rounding off of Income and Rounding off of Income Tax
- 20.4 Calculation of Tax Liability
- 20.5 Illustrations
- 20.6 Summing Up
- 20.7 Check Your Progress: Model Answers
- 20.8 Model Examination Questions

20.0 AIMS AND OBJECTIVES

The objectives of this unit are to familiarise you with the rates of income tax as applicable to individuals and explain you the computation of tax liability.

After completing this unit, you will be able to:

- * mention the income tax rates relating to individual assesseees.
- * compute the tax liability of individuals.

20.1 INTRODUCTION

We have stated in the beginning of the course that though the Income-Tax Act, 1961, is fairly bulky, the rates of income-tax have not been given therein. There is a provision to enact a Finance Act every year. For example, the rates at which income tax has to be paid during the assessment year 1992-93 have been prescribed by the Finance Act, 1991. The Finance Act also contains the rates at which income tax is to be deducted at source during the current financial year which will be the previous year for the coming assessment year. For example, the Finance Act also contains the rate structure at which the assessee will be required to pay Income-tax in advance or the rates at which income-tax has to be deducted at source during the Financial Year 1991-92.

The income is earned in the previous year and the assessment of total income takes place during the following financial year which is known as the assessment year. For example, income earned during the previous year 1991-92 will be assessed in the assessment year 1992-93.

Income-tax is payable in India according to slab system. The total income is broken into a few slabs of certain amounts. Each successive slab is taxed at a higher rate progressively. For example, where the total income is Rs. 50,000, we may have say first slab of Rs. 22,000 second of Rs. 8,000, and third Rs. 20,000. The first slab can go tax free whereas the second and third slabs could be charged at the rates of 20% and 30% respectively.

20.2 TAX REBATE U/S 88

Tax Rebate u/s 88 in respect of life insurance premia, contribution to provident fund etc.

Tax rebate u/s 88 is available to an individual, hindu undivided family and to certain association of persons or body of individuals.

To calculate tax rebate u/s 88, we have to first calculate gross qualifying amount.

Gross qualifying amount: Gross qualifying amount is the aggregate of the following:

1. Life Insurance Premium

Any sum paid in the previous year by an individual assessee to effect or to keep in force an insurance on his life, the life of the spouse or any child of the assessee, qualifies for tax rebate under this section. However, the qualifying premium is restricted to 10 percent of the capital sum assured. For example where the life is insured for a sum of Rs. 1,00,000, the maximum premium that would qualify for tax rebate under this section would be Rs. 10,000. In case the assessee pays Rs. 12,000, he will get tax rebate in respect of Rs. 10,000 only.

You would be interested in knowing that at maturity when the insurance amount is received, it is just like capital receipt and there is no question of taxing that amount.

2. Termination of Life Insurance Policy

Since there is a deduction available in respect of Life Insurance Premium there has been a tendency with the assessee to insure lives for heavy amounts and then stop paying premium after some time when he falls short of money. The Government felt that this tendency should be curbed. Now it is provided that where an assessee discontinues life insurance policy before premiums for two years have been paid, no tax rebate will be allowed in respect of such policy. Whatever rebate has been allowed in an earlier year will be deemed to be the income of the assessee in the year in which the policy is terminated.

3. Contract for Deferred Annuity

Annuity is the annual payment. In order to secure an annual payment after sometime or after retirement, the assessee may pay some amount every year to some institution like Life Insurance Corporation which is just like savings for future. In future instead of getting a capital sum, the arrangement will ensure payment of an annual amount regularly. The amount paid now for securing the annual payment is also eligible for deduction under this section. The annuity could be bought on his own life, on his spouse or children. There is one more condition. The annuity contract should not permit lumpsum payment in lieu of the payment of the annuity.

4. Contribution to Statutory Provident Fund qualifies for tax rebate under this section.
5. Contribution to Government Provident Fund qualifies for tax rebate under this section.
6. Contribution to Public Provident Fund qualifies. The minimum amount to be deposited is Rs. 100.
7. Contribution to recognised provident fund qualifies for rebate of tax under this section.
8. Contribution to Approved Superannuation Fund also qualifies for tax rebate.

9. Family Pension Fund

These days almost all employees have started family pension fund which is other than the pension which is payable by the employer as a matter of employment contract. Almost all State Governments have started these funds. There is no contribution from the employer. It is used for giving a specified amount on the death of a member of the fund while he/she is in service. Amount contributed to family pension fund qualifies for rebate of tax.

10. Unit Linked Insurance Scheme of the UTI

Amount paid to the Unit Trust of India by the assessee under the Unit Linked Insurance Scheme qualifies for tax rebate.

11. Cumulative Time Deposit in Post Office

Amount deposited in the previous year in a 10 or 15 Year Account of the Post Office under Post Office Cumulative Time Deposit Scheme qualifies.

12. Deferred Annuity in the case of Government Employees

Any sum deducted in the previous year from the salary payable by or on behalf of the Government for securing to him a deferred annuity or making provision for his wife or children. The maximum amount that will qualify is one-fifth of salary.

13. National Savings Certificates VI, VII and VIII issues

Amount invested in buying National Savings Certificates qualifies for tax rebate. They now carry interest at the rate of 11 percent per annum and the amount is repayable after six years. On VI issue interest accumulates and is payable at the end of the period. In respect of VII issue, interest is payable every six months.

Interest accruing on VIth issue for every half year is supposed to be reinvested and therefore the assessee will be entitled to rebate of tax under this section in respect of the interest that has accrued but not received.

14. Contribution for participation in notified unit-linked insurance plan of the L.I.C. Mutual Fund (i.e. Dhanaraksha plan).

15. Any sum paid as subscription to House Loan Account Scheme of the National Housing Bank.

16. Any payment made to specified institutions towards the cost of purchase/construction of a new residential house property upto Rs. 10,000 in a previous year is eligible for tax rebate.

17. Other deposit schemes:

Subscription to any deposit scheme of a public sector company engaged in providing long-term finance for construction or purchase of houses in India for residential purposes. (w.e.f. the A.Y. 1993-94).

Amount of tax rebate: 20 percent of gross qualifying amount or Rs. 10,000 which ever is less is the tax rebate available under this section. However, in the case of author, playwright, artist, musician or sportsman (athlete), the tax rebate available is 20% of gross qualifying amount or Rs. 14,000 which ever is less.

Note: 1) W.e.f. the A.Y. 1993-94, the subscriptions to the schemes at present covered under section 80 CCA and 80 CCB have been included under this sub-section (1) of Section 88 and thereby they are made eligible for tax rebate as per the limits indicated below. In other words Sec. 80 CCA and 80 CCB will be dropped from the A.Y. 1993-94.

Note: 2) W.e.f. the A.Y. 1993-94 the amount of tax rebate is revised as follows:

- i) In the case of an individual whose income derived from the exercise of his profession as an author, play wright, artist, musician, actor or sportsman is 25% or more of his total income: 25 percent of the gross qualifying amount or Rs. 17,500 whichever is less.
- ii) In the case of any other individual: 20 percent of gross qualifying amount or Rs. 12,000 whichever is less.

Note: 3) W.e.f. the A.Y. 1993-94, an additional rebate of 10 percent of the net tax payable will be allowed to individuals resident in India who are of the age of 65 years or more at any time during the relevant previous year and have a gross total income not exceeding Rs. 50,000 (Sec. 88 B).

Check Your Progress - I

What is the rate of rebate allowable under section 88?

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.....
.....

20.3 ROUNDING OFF OF INCOME AND ROUNDING OFF OF INCOME TAX

The amount of total income, shall be rounded off to the nearest multiple of Rs. 10 and for this purpose any part of a rupee consisting of paise shall be ignored and thereafter if such amount is not a multiple of Rs. 10 the last figure in the amount being five or more the amount shall be increased to the next higher amount which is a multiple of Rs. 10. If the last figure is less than five, it is rounded off to the next lower amount which is a multiple of Rs. 10. The amount so rounded-off shall be deemed to be the total income of the assessee for the purpose of this Act.

To illustrate total income amounting to Rs. 50,465 is rounded off to Rs. 50,470, whereas Rs. 50,464 is brought down to Rs. 50,460.

Rounding off of tax etc.

According to Section 288 B the amount of tax (including tax deductible at source or payable in advance, interest, penalty, fine or any other sum) payable and the amount of refund due shall be rounded-off to the nearest rupee. For this purpose where such amount contains a part of a rupee consisting of paise such part being 50 paise or more it shall be increased to one rupee. If such a part is less than 50 paise, it shall be ignored, For example; Rs. 194.49 shall be rounded off to Rs. 194. If the tax amounts to Rs. 245.52 the assessee has to pay Rs. 246.

20.4 CALCULATION OF TAX LIABILITY

While calculating the tax liability of an individual, the following steps are to be followed:

- i) First net income of an individual is chargeable to tax for A.Y. 1992-93 (Finance Act 1992) at the rates given below:

- | | | |
|----|--------------------------------|-----|
| 1. | On the First Rs. 22,000 | Nil |
| 2. | On the next Rs. 8,000 | 20% |
| 3. | On the next Rs. 20,000 | 30% |
| 4. | On the next Rs. 50,000 | 40% |
| 5. | On the balance of total income | 50% |

Surcharge: If the total income exceeds Rs. 75,000, the assessee shall be liable to pay a surcharge @12% of the amount of net income tax.

Net income tax = Tax on total income (after making adjustments for tax on agricultural income) -- Rebates u/s 88

If the individual has agricultural income, due consideration is to be given to the rules relating to that income.

- ii) Second, from the amount of tax determined as above, the following tax reliefs/rebates are to be deducted if applicable to that individual.

- Rebate under Sec. 86 in respect of share of profits from an unregistered firm or association of persons.
- Relief under Sec. 89 (1) in respect of salary paid in advance or in arrears.
- Relief under Sec. 91 in respect of doubly taxed income.
- Rebate under Sec. 88.

Check Your Progress - 2

Mr. 'X' an Individual has a total income of Rs. 50,000 for the A.Y. 1992-93. He has paid insurance premium of Rs. 4,000. Calculate his tax liability.

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20.5 ILLUSTRATIONS

- Compute tax liability in the following cases for the assessment year 1992-93.
 - Anil, an individual whose total income is Rs. 35,400.
 - Singh, an individual whose total income is Rs. 23,500.

Solution

a) ANIL: TOTAL INCOME RS. 35,400.	Rs.
Income tax on the first Rs. 22,000	Nil
Income-tax on the next Rs. 8,000, 20%	1,600
Income tax on the balance of Rs. 5,400, 30%	1,620
Total Tax	3,220
b) SINGH: TOTAL INCOME RS. 23,500:	
Income-tax on the first Rs. 22,000	Nil
Income-tax on the balance of Rs. 1,500 at 20%	300
Total Tax	300

2. Compute tax liability in the following case for the assessment year 1992-93.
An Individual Mr. Gopal shows total income of Rs. 32,000 in his return of income.

Solution

INDIVIDUAL GOPAL: TOTAL INCOME Rs. 32,000	
Income-tax on the first Rs. 22,000	Nil
Income-tax on the next 8,000 at 20 percent	1,600
Income-tax on the balance of Rs. 2,000 at 30%	600
Total Tax	2,200

3. Compute the tax liability of Mr. Rao from the following particulars for the A.Y. 1992-93.
- Total Income Rs. 38,000
 - Tax deducted at source Rs. 500
 - He paid Rs. 7,000 by way of LIC Premium on his Life Insurance
 - He contributed Rs. 1,000 to P.F.

Solution

Calculation of tax liability of Mr. Rao for the A.Y. 1992-93.

Total Income	Rs.
Tax:	38,000
First Rs. 22,000 of total income	Nil
Next Rs. 8,000 of total income @ 20%	1,600

Balance Rs. 8,000 of total income @ 30%	<u>2,400</u>	4,000
Less: Tax deducted at source		<u>500</u>
Balance Tax		3,500
Less: Rebate u/s 88:		
Qualifying Amount:	Rs.	
LIC Premium	7,000	
PF contribution	1,000	
	<u>8,000</u>	
		1,600
20% of Rs. 8,000		<u>1,900</u>
Net Tax payable		

4. Mr. Ramana gives the following details of his income. Calculate his tax liability for the A.Y. 1992-93.

- Salary income Rs. 36,000
- He is contributing Rs. 300 p.m. to Recognised Provident Fund and depositing Rs. 200 p.m. in 10-year C.T.D account. Annual Insurance premium paid by him is Rs. 1,500 on the sum assured Rs. 10,000.

Solution

Calculation of Tax Liability of Mr. Ramana for the A.Y. 1992-93.

		Rs.
Salary income being total income		<u>36,000</u>
First Rs. 22,000 of total income	Nil	
Next Rs. 8,000 of total income of @ 20%	1,600	
Balance Rs. 6,000 of total income @ 30%	<u>1,800</u>	
Total tax		3,400
Less: Rebate u/s 88		
Qualifying amount:		
i) Contribution to provident fund	3,600	
ii) C.T.D. Deposit	2,400	
iii) L.I.C. Premium Restricted to 10% of the sum assured	<u>1,000</u>	
	<u>7,000</u>	
20% of Rs. 7,000		<u>1,400</u>
Net tax payable		<u>2,000</u>

5. From the particulars given below, compute the tax liability of Mr. Sri Ram for the Assessment Year 1992-93.

	Rs.
(i) Income from let-out house (computed)	15,000
(ii) Dividend from shares (Gross)	3,000
(iii) Business Income	20,000
(iv) He paid LIC Premium	2,000

Solution

Computation of total income of Mr. Sri Ram and his tax liability for the A.Y. 1992-93.

	Rs.
Income from House-Property	15,000
Business Income	20,000
Income from other sources:	
Dividend	3,000
Gross Total Income	38,000
(-) Deduction u/s 80L (Dividend)	3,000
Total Income	35,000
Tax Liability	
First Rs. 22,000	Nil
Next Rs. 8,000 @ 20%	1,600
Balance Rs. 5,000 @ 30%	1,500
Total Tax	3,100
(-) Rebate u/s 88	
Qualifying Amount Rs. 2,000	
$2,000 \times 20 / 100$	400
Net tax payable	2,700

20.6 SUMMING UP

Computation of tax liability in respect of Individual assessee is explained in this unit. The amount of total income is to be rounded off to the nearest ten rupees and the tax to the nearest rupee. After the tax is calculated as per the applicable rates of tax, the rebate under section 88 is to be deducted, so as to get net tax payable by the assessee.

20.7 CHECK YOUR PROGRESS: MODEL ANSWERS

1.	20% of Qualifying amount for rebate under section 88.		
2.	On first Rs. 22,000	Nil	
	Next Rs. 8,000	20%	1,600
	Next Rs. 20,000	30%	<u>6,000</u>
	Total Tax		7,600
	(-) rebate of tax		<u>800</u>
	Net tax payable		<u>6,800</u>

20.7 MODEL EXAMINATION QUESTIONS

I. Solve the following problems:

1. Compute the tax liability of Mr. Bihari Lal from the following particulars:

- a) Total income Rs. 55,800
- b) Agricultural Income Rs. 8,000

He paid LIC Premium of Rs. 5,000; and deposited Rs. 4,000 in P.O. 10 Year CTD Account.

2. 'M' an Individual supplies you the following information for computation of his tax liability for the assessment year 1992-93.

	Rs.
1. Income from house property (computed)	10,000
2. Profit from business	5,000
3. 1/3 share of profit from an unregistered firm	10,000
4. Interest on securities (gross) (listed)	8,000
5. Interest on tax-free Govt. Securities	2,000
	<u>35,000</u>

He paid Rs. 3,000 as life insurance premium and donated Rs. 5,000 to an institution approved by the Income-Tax Department. Income Tax was deducted at source at 10% from the amount of interest on securities.

II. Answer the following short questions in 15 lines each

- 1. What are the different rules prescribed for computing net agricultural income for inclusion in total income under the partial integration scheme?
- 2. How do you compute income-tax liability of a person?
- 3. How do you round off total income and income tax?

UNIT-21: REVISIONARY PROBLEMS

Contents

- 21.0 Aims and Objectives
- 21.1 Introduction
- 21.2 Problems
- 21.3 Summing Up
- 21.4 Model Examination Questions

21.0 AIMS AND OBJECTIVES

The objective of this unit is to recapitulate what we have studied so far under the subject, income-tax with the help of a few problems

After completing this unit, you will be able to solve problems on the computation of total income of individuals.

21.1 INTRODUCTION

In continuation to the description given in the previous units, an attempt is made in this unit to solve different problems covering the various provisions of the Act.

21.2 PROBLEMS

1. The following items show the income of Shri Ashoka for the previous year 1992-93.
 1. Profit from business in Iran received in India Rs. 5,000
 2. Income from house property of Iran received in India Rs. 5,000
 3. Income from house property in Pakistan, deposited in a Bank there Rs. 1,000.
 4. Profits of Business established in Paris deposited in a Bank there Rs. 1,000 - this business is controlled from India.
 5. Income accrued in India but received in England Rs. 2,000.
 6. Profit earned from business in Kanpur Rs. 6,000.

From the above particulars, ascertain the taxable income of Shri Ashoka for the previous year 1991-92, if he is (i) a resident (ii) a not ordinarily resident (iii) a non - resident.

Solution

Particulars of Income	Resident	Not Ordinarily Resident	Non Resident
	Rs.	Rs.	Rs.
1. Profit from Business in Iran received in India	5,000	5,000	5,000
2. Income from house property in Iran received in India	5,000	5,000	5,000

3.	Income from house property in Pakistan, deposited there	1,000	-----	-----
4.	Profit from business established in Paris deposited in a bank there, business controlled from India	1,000	1,000	-----
5.	Income accrued in India but received in England	2,000	2,000	2,000
6.	Profit earned from business in Kanpur	6,000	6,000	6,000
	Taxable Income	20,000	19,000	18,000

2. Compute the total income of Mr. Y who is working as Sales Manager of Z Company Limited, Bombay, for the current assessment year. He received the following incomes and perquisites in the accounting year:

i)	Salary	Rs.	3,000	p.m.
ii)	Dearness Allowance, as per terms of employment, it is included into computation of service benefits.	Rs.	600	p.m.
iii)	Employers contribution to RPF: Mr. Y. also contributes a like amount each month.	Rs.	400	p.m.
iv)	Interest credited to Mr. Y's balance in the PF @ 11% p.a.	Rs.	2,400	
v)	Entertainment Allowance granted regularly since 1954	Rs.	7,400	
vi)	Rent-free unfurnished accommodation. Rent paid by the employer	Rs.	800	p.m.
vii)	Free use of a 20 H.P. Car Running and maintaining expenses wholly incurred by the employer	Rs.	2,800	
viii)	Dividends from a cooperative society (Gross)	Rs.	1,200	
ix)	He received Rs. 2,700 as interest on units of UTI and dividend from Indian company Rs. 7,760 (after deduction of tax @ 22.4%)			
x)	He invested Rs. 6,000 in CANPEP (a notified equity linked deposit scheme)			

Mr. Y was resident for the previous year and he paid Rs. 3,500 as insurance premium on a policy of Rs. 30,000 taken on his life.

Solution

I) Income from Salary:

	Rs.	Rs.
Salary	36,000	
Dearness Allowance	7,200	

Employer's contribution to
RPF in excess of 10% of salary
(Rs.4,800 - 4,320) 480

Entertainment Allowance 7,400

Value of Rent-Free Accommodation:
10% of Salary (Rs. 36,000+7,200 = 43,200) 4,320

Car Expenses 2,800

Gross Salary 58,200

Less: Standard Deduction 12,000

Entertainment Allowance 7,200

2. **Income from other Sources:** 39,000

Dividends from Cooperative Society 1,200

Interest from U.T.I. 2,700

Dividend from Indian Company 10,000 13,900

Gross Total Income 52,900

Less: Deductions:

u/s 80 CCB 6,000

u/s 80 L 12,700

Total Income 18,700
34,200

Notes:

1. Car expenses of Rs. 2,800 can be directly taken into account because it is clearly given in the problem.
2. Calculation of Exempted Entertainment Allowance: Least of the following four will be exempted from tax:
 - a) Actual E.A. Rs. 7,400
 - b) E.A. before 1-4-1955 Rs. 7,400
 - c) Statutory limit Rs. 7,500
 - d) 1/5th of Salary (36,000 x 7/5) Rs. 7,200

3. Calculation of qualifying amount for Rebate u/s 88:

Contribution to P.F Rs. 4,800

LIC Premium (Restricted) 3,000

7,800

4. Computation of deduction u/s 80 L:

General Maximum deduction:	Rs. 7,000
Additional deduction for dividends from Indian Companies	Rs. 3,000
Additional deduction for income	Rs. 2,700
From U.T.I.	12,700

3. A's investments for the previous year ended 31st March 1992 were as given below:

- Rs.
- 30,000 5 percent Municipal Debentures.
 - 20,000 $4\frac{1}{2}$ percent Port Trust Bonds.
 - 10,000 4 percent Bombay Development Loan.
 - 32,000 $3\frac{1}{2}$ percent Tax Free Government of India Loan
 - 32,000 11% Convertible Debentures of a Company.
 - 16,000 6% Debentures of Company
 - Rs. 10,000 in 5 years National Development Bonds. Interest accrues at 13 percent and payable on maturity. They were bought on 1-10-1991.
 - Rs. 15,000 in 6 year National Savings Certificates (VI Issue): Interest at 12% per annum accrues but paid on maturity. They were bought on 1-10-1991.
 - Rs. 20,000 in 7 years National Savings Certificates (II Issue): Interest at 6% per annum accrues annually. They were bought on 1-2-1991.

On 1st September, 1991, he bought Rs. 40,000 5 percent U.P. Govt. Loan, the interest on which is payable on 30th June and 31st December. For this purpose he took a loan of Rs. 30,000 at 6% per annum. The bank charged 1 percent commission on purchase of securities and 2 percent commission on realisation of gross interest.

Find out his taxable income under the head 'Income from other sources' for the assessment year 1992-93.

Solution

	Rs.
a) Rs. 30,000 5 percent Municipal Debentures	1,500
b) Rs. 20,000 $4\frac{1}{2}$ % Port Trust Bonds	900
c) Rs. 10,000 4 percent Bombay Development Loan	400
d) Rs. 32,000 $3\frac{1}{2}$ percent Govt. of India Loan (Tax Free)	1,120
e) Rs. 32,000 11 percent Convertible Debentures	3,520
f) Rs. 16,000 6 percent Debentures of a Company	960

g) Rs. 10,000 13 percent 5 year National Development Bonds (interest for six months only)	650
h) Rs. 15,000 6 Year National Savings Certificates 12% (Interest for three months)	450
i) Rs. 40,000 5% U.P. Govt. Loan for six months	1,000
	<u>10,500</u>

Less: i) Interest on Bank Loan of Rs. 30,000 @ 6% for 7 months	1,050
ii) Bank commission at 2% on Rs. 10,500.	<u>210</u>
	1,260
Income from Other Sources	<u>9,240</u>

NOTES

1. Commission on purchase of securities is not allowable.
2. Rebate of income-tax on Rs. 1,120 being interest on tax free Govt. Securities will be allowed at an average rate of $27\frac{1}{2}\%$ whichever is less.
3. Interest on 7 Year National Savings Certificates (II Issue) is completely tax-free and, therefore, it is not includible in total income.
4. Smt. Sashikala is a radio play back-Singer whose particulars of receipts and expenditure are given below. You are required to compute her total income for the assessment year 1992-93.

Receipts		Payments	
Radio Programmes	8,950	Telephones & Telegrams	5,000
Film Corporation	10,540	Typist and Clerk	12,000
From other Producers	50,250	Attendants	12,000
Rent received	8,000	Private Secretary	12,000
Dividends received (net)	7,800	Tour abroad	50,000
UTI Interest received	2,000	Car expenses	18,460
Special programmes	3,000	Municipal Taxes (Let out house)	800
Programmes in London and New York	1,00,000	Municipal Taxes (self occupied)	1,000
		Surplus	79,280
	<u>1,90,540</u>		<u>1,90,540</u>

It was found that one fourth of the Car expenses pertain to private use thereof. The attendants are also working in the house performing duties not related to profession.

According to FERA provisions she brought the entire income from foreign sources to India.

Solution

I. Income from House Property

Let out house: Rent Received	8,000	
Municipal taxes	<u>800</u>	
	<u>7,200</u>	
Self occupied house:	Nil	
		7,200
Less: 1/6 for repairs	<u>1,200</u>	6,000

II. Profit from Profession

Radio Programmes	8,950	
Film Corporation	10,540	
Other Producers	50,250	
Special Programmes	3,000	
Receipts from tour	<u>1,00,000</u>	
		1,72,740
Less: Expenses		
Telephones & Telegrams	5,000	
Typist and Clerk	12,000	
Private Secretary	12,000	
Tour Expenses	50,000	
Car Expenses	18,460	
Less: Private use	<u>4,615</u>	<u>13,845</u>
		<u>92,845</u>
		79,895

III. Income from Other Sources

Dividends (gross) [7,800x100/77.6]	10,052	
UTI Interest	<u>2,000</u>	<u>12,052</u>
Gross Total Income		97,947
Deduction u/s 80L		
Dividends etc.	10,000	

Additional for UTI	<u>2,000</u>	12,000
U/S 80 RR 75% of income brought into India from foreign sources [1,00,000-50,000]	<u>37,500</u>	<u>49,500</u>
Total Income		<u>48,447</u>

NOTES

1. Annual value of the self-occupied house is taken to be nil.
2. As the full information is not available about the expenditure on attendants, no deduction is allowed.
5. The following are the particulars of assets sold by Mr. Sampatkumar during the previous year 1991-92.
 - a) Residential house purchased on 1-1-1987 for Rs. 45,000 sold on 1-3-92 for Rs. 80,000.
 - b) House let out by him was purchased on 1-1-1990 at a cost of Rs. 70,000 was sold in December, 1991 for Rs. 1,00,000.
 - c) Factory machinery purchased for Rs. 20,000 in 1962 of the written down value as on 1-4-1991 Rs. 6,000 sold on 1-1-1992 for Rs. 6,000.
 - d) Factory machinery purchased in July 1990 for Rs. 10,000 sold for an amount Rs. 12,000.
 - e) Motor Truck purchased for Rs. 1,20,000 during the year was sold at Rs. 1,15,000.
 - f) Shares of the Jute Company purchased on 1-2-1989 for Rs. 15,000 sold on 1-4-1991 for Rs. 20,000.

During the year Mr. Sampatkumar purchased a new residential house for Rs. 20,000. His other incomes for the year amounted to Rs. 40,000.

Compute his total income for the assessment year 1992-93.

Solution

Long-term Capital gains

i) Sale of residential house (Rs. 80,000-45,000)	35,000
Less: Deduction u/s 54 for having bought another house for his own residence	<u>20,000</u>
	15,000
Less: Deduction u/s 48	
First Rs. 15,000 - 100%	<u>15,000</u>
	Nil

ii)	Sale of Shares	5,000		
	Less: Deduction u/s 48			
	60% of Rs. 5,000	<u>3,000</u>	<u>2,000</u>	<u>2,000</u>
Short-term Capital gains				
iii)	Sale of let out house (1,00,000-70,000)	30,000		
iv)	Sale of factory machinery [12,000-10,000]	<u>2,000</u>		
		32,000		
v)	Loss on sale of truck-short term	<u>5,000</u>	<u>27,000</u>	
	Income from capital gains		29,000	
	Income from other sources		<u>40,000</u>	
	Gross Total Income		69,000	
	Deduction		Nil	
	Total Income		<u>69,000</u>	

NOTES

1. It has been assumed that the new house purchased by the assessee has been for his own residential purposes. It is therefore, preferable to claim deduction under section-54.
2. Since machinery mentioned under (C) has been sold at the written down value, there is neither profit nor gain. Depreciation is not allowed in respect of the asset in the year in which it is sold, destroyed etc.
6. From the particulars given below, compute the total income of Miss Geetha, a resident of Kakinada.
 - I. Salary Rs. 2,000 p.m.
T.A.Bill Rs. 5,000 p.m.
Actual expenditure Rs. 6,000 p.m.
 - Her contribution to statutory provident fund Rs. 300 p.m. Employer's contribution to SPF-10% of salary. Interest on accumulated balance of SPF at 13% - Rs.2,000.
 - II. She owns two houses, one of which is let out at a rent of Rs. 400 p.m. and the other was occupied by her. The annual value of the house occupied by her is Rs. 1,000. The two houses are subject to Municipal Taxes of Rs. 600 and Rs. 100 respectively.
 - III. She received Rs. 1,500 (gross) as interest from the Government Securities and Rs. 1,600 as gross dividend.
 - IV. She pays Life Insurance premium of Rs., 5,000 on her life policy of Rs. 60,000. She deposited Rs. 250 p.m. in post office CTD 10 year account.

Solution**Computation of Total Income of Miss Geetha for the Current Assessment Year**

	Rs.	Rs.
I. Income from salary		
Salary at Rs. 2,000 p.m.	24,000	
Less standard deduction u/s 16(1) (33 1/3% of gross salary or Rs. 12,000 w.e.l.)	<u>8,000</u>	16,000
II. Income from House Property		
Gross annual value	4,800	
Less: Municipal Taxes	<u>600</u>	
Net Annual Value	4,200	
less Deduction u/s 24		
Repairs 1/6th of N.A.V.	<u>700</u>	3,500
III. Income from other sources		
Dividend (gross)	1,600	
Interest on securities	<u>1,500</u>	<u>3,100</u>
Gross Total Income		22,600
Less: Deduction u/s 80L		<u>3,100</u>
Total Income		<u>19,500</u>

Notes: 1 Q.A. for rebate u/s 88.

	Rs.
Contribution to SPF	3,600
Life Insurance premium	5,000
Contribution to PO CTD a/c	<u>3,000</u>
	<u>11,600</u>

2. Travelling allowance is fully exempted.

7. The following particulars are given by Mrs. Valli, Visakhapatnam, in respect of her annual income for the year ended 31st March, 1992.

- i) Basic Rs. 3,500 p.m.
- ii) House rent allowance at 20% of basic.
- iii) Actual house rent paid Rs. 1,500 p.m.

- iv) Contribution to RPF by self and employer each 10% of basic.
- v) Life Insurance premium paid Rs. 1,200.
- vi) Travelling allowance received Rs. 2,500 Rs. 2,000 was spent for official duties.
- vii) Interest and dividend incomes:
 Interest on deposits with State Bank of India Rs. 6,000.
 Income from units of UTI Rs. 3,000.
 Interest on debentures of Ponds India Ltd., Rs. 1,750.
 Dividend from an Indian Company Rs. 5,000.
- viii) Medical expenses spent for her family Rs. 5,000. Her employer reimbursed Rs. 2,500.
- ix) Rent received from tenant of her own house property Rs. 9,600 Municipal Taxes paid Rs. 960.

Solution

Computation of Mrs. Valli's total income for the A/Y 1992-93.

	Rs.	Rs.
I. Salaries		
Basic (3,500x12)	42,000	
Travelling allowance (2,500-2,000)	500	
Gross Salary	42,500	
Less: Standard deduction u/s 16 (i)		
$33\frac{1}{3}\%$ of gross salary or		
Rs. 12,000 w.e.l	<u>12,000</u>	30,500
II. House property:		
Gross annual value	9,600	
Less Taxes	<u>960</u>	
Net annual value	8,640	
Less: repairs 1/6th of N.A.V.	<u>1,440</u>	7,200
III. Income from other sources:		
Interest on Bank Deposit	6,000	
Income from Units of UTI	3,000	
Dividend	5,000	

Interest on debentures	<u>1,750</u>	<u>15,750</u>
Gross Total Income		53,450
Less: Deduction u/s 80L		<u>13,000</u>
Total Income		<u>40,450</u>

Notes i)	H.R.A. exemption	
	H.R.A. received 8,400	
	Rent paid-10% of	
	Salary (18,000-4,200) 13,800	
	50% of salary 21,000	
	w.e.l. is exempted	
ii)	Q.A. for rebate of tax u/s 88	
	Own contribution to RPF	4,200
	Life Insurance Premium	<u>1,200</u>
		<u>5,400</u>

8. Given below is the profit and loss account of Mr. Prasad for the year ended 31.3.1992.

Dr.	Rs.	Cr.	Rs.
To Salaries	7,000	By Cross profit	50,000
To Drawings	8,000	By interest on Post Office Saving Bank Account	100
To Life Insurance premium	1,000	By Proceedings from Life Insurance Policy	6,900
To Depreciation	4,500	By Interest on Bank Deposits	3,600
To Donation to recognised Institution	500		
To General Expenses	2,600		
To Education expenditure of his sons'	6,600		
To provision for doubtful debts	1,500		
To Income Tax	2,000		
To Rent 1,700			
To Net Profit	25,200		
	<u>60,600</u>		<u>60,600</u>

Compute his taxable income for the A/Y 1992-93 after taking the following information into consideration.

- a) The amount of allowable depreciation is Rs. 4,000.
- b) General expenses include Rs. 600 for his private expenses.

Solution

Computation of total Income of Mr. Prasad for the A/Y 1992-93.

I. Profits from business:

Net profit as per Profit & Loss a/c	25,200	
Add Inadmissible expenses:		
Drawings	8,000	
Life Insurance premium	1,000	
Depreciation	4,500	
Donations	500	
Education expenditure of his sons	6,600	
Provision for doubtful debts	1,500	
Income tax	2,000	
Private expenses	<u>600</u>	<u>24,700</u>
		49,900
Less Incomes not taxable under this head:		
Interest on P.O.Savings Bank a/c	100	
Proceeds from Insurance policy	6,900	
Interest on Bank Deposits	<u>3,600</u>	<u>10,600</u>
Less Admissible deductions		39,300
Depreciation	<u>4,400</u>	35,300

II. Income from other sources:

Interest on Bank deposits		<u>3,600</u>
Gross Total Income		38,900
Less Deduction u/s 80 G (50% of 500)	250	
Deduction u/s 80L	3,600	<u>3,850</u>
Total Income		<u>35,050</u>

NOTES

1. Interest on P.O.Savings Banks account and proceeds from Life Insurance Policy are not taxable.

2. Qualifying amount for tax rebate u/s 88

Life Insurance Premium 1,000

9. For the A/Y 1992-93, Mr. Venkat, a resident of Hyderabad, furnished the following information.

Basic pay Rs. 18,000

Project allowance Rs. 15,000

Education allowance (Rs. 150 p.m. for 3 children) Rs. 5,400

Hostel allowance (Rs. 500 per month for 1 child) Rs. 6,000

Free car facility for his family, cost to the employer Rs. 2,000

Employer's contribution towards unrecognised P.F. Rs. 2,000

Share of profit from:

a registered firm Rs. 36,000

an unregistered firm Rs. 42,000

an association of persons Rs. 34,000

a Hindu Undivided family Rs. 18,000

Income from betting Rs. 2,400

Income from business Rs. 81,600

Payments and Investments:

Contribution towards unrecognised P.F. Rs. 1,700

Payment of insurance premium on father's life Rs. 500

Payment of premium on own Mediclaim policy Rs. 3,000

Deposit in 10 year P.O.Savings Bank (CTD) Rules of 1959 Rs. 5,000

Donation to an approved public charitable institution Rs. 3,000

Determine total income of Mr. Venkat for the A/Y 1992-93.

Solution

Computation of Total Income of Mr. Venkat for the A/Y 1992-93.

I.	Income from salary:	Rs.	Rs.
	Basic pay	18,000	
	Project Allowance	15,000	
	Education Allowance (5,400-1,200)	4,200	
	Hostel allowance (6,000-1,800)	4,200	
	Car	2,000	
	Gross Salary	43,400	
	Less: Standard deduction	12,000	31,400
II.	Profits and gains of business or profession:		
	Profits from registered firm	36,000	
	Profits from unregistered firm	42,000	
	Profits from an association of persons	34,000	
	Profits from business	81,600	1,93,600
	Gross Total Income		2,25,000
	Less		
	Deduction u/s 80D (Mediclaime premium)	3,000	
	Deduction u/s 80G (50% of 3,000)	1,500	4,500
	Total Income		2,20,500

NOTES

1. Education allowance is exempted to the extent of Rs. 50 p.m. per child upto two children ($50 \times 12 \times 2 = 1200$)
2. Hostel allowance is exempted to the extent of Rs. 150 p.m. per child upto two children. But it was given for one child only. ($150 \times 12 = 1800$)
3. The perquisite value of car is taxable as Mr. Venkat is specified employee (salary exceeds Rs. 24,000 p.a)
4. Employer's contribution to unrecognised PF is not taxable.
5. Income from betting is exempted as casual income, because it is below Rs. 5,000.
6. Share of profit from HUF is not taxable.
7. Q.A. for tax rebate u/s 88.

Life Insurance Premium on father's life	500
Deposit in P.O Savings Bank (CTD)	5,000
	5,500
8. Contribution towards unrecognised PF is not eligible for rebate u/s 88.

10. Mr. Krishna Rao, a lecturer in Ambedkar Open University, submits the following particulars of income and payments for the A/Y 1992-93.

	Rs.
Basic Salary	4,500 p.m.
Dearness allowance	300 p.m.
Wardenship allowance	600 p.m.
Examinership remuneration	4,000
Royalty from books (computed)	73,920
Income from house property	5,000 (computed)
Interest on Government securities	2,000
Dividend from a private limited company	2,600
Contribution to SPF	7,000
Contribution to PPF	42,000
Medical insurance premium on his mother's health	3,000 (dependent)

Donation to an approved charitable institution Rs. 30,000. Determine the total income of Mr. Krishna Rao for the A/Y 1992-93.

Solution

Computation of Total Income of Mr. Krishna Rao for the A/Y 1992-93.

	Rs.	Rs.
I. Income from salary		
Basic (4,500x12)	54,000	
Dearness Allowance (300x12)	3,600	
Wardenship allowance (600x12)	<u>7,200</u>	
Gross Salary	64,800	
Less: Standard deduction	<u>12,000</u>	52,800
II. Income from house property		5,000
III. Income from other sources:		
Examinership remuneration	4,000	
Royalty from books	73,920	
Interest on Government Securities	2,000	
Dividends from private		

limited company	<u>2,600</u>	<u>82,520</u>
Gross Total Income		1,40,320
Less: Deduction u/s 80 D		
(Medical insurance premium)	3,000	
Deduction u/s 80G(50% of 13,272)	6,636	
Deduction u/s 80L		
(Interest + dividend)	<u>4,600</u>	<u>14,236</u>
Total Income		<u>1,26,084</u>
Rounded off to Rs. 1,26,080		

NOTE

1. Deduction u/s 80G. Gross Qualifying amount of Rs.30,000 or 10% of Gross taxable income (i.e. 1,40,320 - 3,000 - 4,600) 13,272 w.e.l.

2. QA for tax rebate u/s 88

Contribution to SPF	7,000
Contribution to PPF	42,000
	<u>49,000</u>

21.3 SUMMING UP

In this unit various problems covering different provisions relating to computation of total income have been illustrated.

21.4 MODEL EXAMINATION QUESTIONS

Solve the following problems

1. Mr. Satyam, a resident of Hyderabad, submits the following details of his income for the previous year 1991-92.
 - i) Salary Rs. 2,800 p.m.
 - ii) D.A. Rs. 3,600 p.a.
 - iii) Entertainment Allowance Rs.300 p.m. (prior to 1-4-55 he was getting Rs.100 p.m.)
 - iv) City Compensatory Allowance Rs. 100 p.m.
 - v) Bonus Rs. 3,000
 - vi) Employer's contribution to the recognised provident fund Rs.4,000.
 - vii) His own contribution to the Fund Rs.4,000.
 - viii) Interest on the accumulated baalance of the Fund @ 9% p .a. Rs. 14,000.

He is provided with an unfurnished house for which the employer charges Rs. 200 p.m. The municipal value of the home being Rs. 6,000 p.a. He is also provided with a 18 H.P. car with a driver by the employer. 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. Satyam has received dividends from Indian companies of Rs.3,500 (gross). He paid insurance premium of Rs. 5,000 on a policy taken on his own life and Rs. 2,000 on the life of his father who is not dependent on him. He has spent Rs. 2,000 on the education of his son studying B.E.

Compute the taxable income of Mr. Satyam for the A.Y. 1992-93.

2. Following are the particulars of the income of Mr. Rao for the year ending on 31-3-1992. Compute his total income:

- I.
 - (i) Pay Rs. 1,000 p.m.
 - (ii) D.A. Rs. 200 p.m. (included in pay for service benefits)
 - (iii) Additional Dearness Allowance Rs. 100
 - (iv) Bonus-one month's salary (Pay + D.A.)
 - (v) Rent-free furnished accommodations Annual rental value is Rs.3,000 and cost of furniture provided in the residence Rs. 17,000.
- II. He owns two houses, one in Hyderabad and another in Vijayawada. Both of them are let out at Rs. 6,000 and Rs. 10,000 respectively. The Municipal value for the first house is Rs. 5,000 p.a., and for the second house is Rs. 12,000.

The following expenses are claimed:

	1st House	2nd House
	Rs.	Rs.
Ground Rent	500	800
Insurance Premium	200	300
Municipal Taxes	500	1,200

Collection charges for both houses Rs. 1,200.

His savings are:

- i) Contribution to public provident fund Rs. 3,000.
- ii) Contribution to Post Office CTD (10 year) A/c-200 p.m.
- iii) LIC premium Rs. 5,000 p.a. on a policy of Rs. 40,000.

3. For the year ending on 31-3-1992. Mr. Laxman furnishes the following particulars of his income from each source:

	Rs.
1. Salary received in India	60,000
2. Profit from business in Germany received in India	5,000
3. Income from house property	2,000
4. Income from other sources	15,000

His savings are

- i) Contribution to RPF Rs. 2,000 p.a.
- ii) LIC premium Rs. 1,500
- iii) Deposit in P.O CTD (10 year) A/C Rs. 2,000.

Compute his total income for the A.Y. 1992-93.

4. Sri Ram Rao a resident of Madras, submits the following details of income for the financial year 1991-92.

1. Salary Rs. 2,800 p.m.
2. D.A. Rs. 300 p.m.
3. Entertainment Allowance Rs. 400 p.m. (prior to 1-4-55 he was getting Rs. 250 p.m.)
4. City compensatory Allowance Rs. 100 p.m.
5. Bonus Rs. 3,000.
6. Employer's contribution to Recognised P.F. Rs. 4,000.
7. His own contribution to R.P.F Rs. 4,000
8. Interest on the accumulated balance of the Fund @10% p.a. Rs. 14,000.
9. He is provided with a furnished house for which the employer charges Rs. 200 p.m. The municipal value of the house being Rs. 6,000 p.a. Cost of the furniture is Rs. 10,000-.
10. He is provided with a car of 18 H.P. by the employer. It is used for both official and personal purposes and the entire expenses are borne by the employer.
11. He received dividends amounting to Rs. 7,000 (Gross).
12. He contributed Rs. 4,000 in ULIP and purchases NSC's (VIII Issue) worth Rs. 6,000 in the previous year. He donated Rs. 4,000 towards P.M.'s National Relief Fund.

Compute his taxable income for the A.Y. 1992-93.

BRAOU

BLOCK - VI

ASSESSMENT

This block is devoted to various important aspects of Assessment. They include Income Tax Authorities, Assessment Procedure, Appeals and Revision, Collection of Tax and Lapses and Consequences.

Unit - 22	:	Income tax Authorities
Unit - 23	:	Assessment Procedure
Unit - 24	:	Appeals and Revision
Unit - 25	:	Collection of Tax
Unit - 26	:	Lapses and Consequences

BRAOU

UNIT-22: INCOME-TAX AUTHORITIES

Contents

- 22.0 Aims and Objectives
- 22.1 Introduction
- 22.2 The Central Board of Direct Taxes
- 22.3 Director General of Income Tax or Chief Commissioner of Income Tax
- 22.4 Directors of Income-Tax or Commissioners of Income-Tax or Commissioners of Income-Tax (Appeals)
- 22.5 Deputy Directors of Income-Tax or Deputy Commissioners of Income-Tax or Deputy Commissioners of Income-Tax (Appeals)
- 22.6 Assistant Directors of Income-Tax or Assistant Commissioners of Income-Tax
- 22.7 Assessing Officers
- 22.8 Tax Recovery Officers
- 22.9 Inspectors of Income-Tax
- 22.10 Summing Up
- 22.11 Check Your Progress: Model Answers
- 22.12 Model Examination Questions

22.0 AIMS AND OBJECTIVES

In this unit we propose to explain the functions of the authorities responsible for collecting income-tax from assesses.

By the end of this unit, you will be able to:

- * explain the various classes of income-tax authorities.
- * discuss the powers of Central Board of Direct Taxes; and
- * list out the functions of various income-tax authorities

22.1 INTRODUCTION

For the purpose of administration and execution of functions in the Act there is a provision for appointing number of authorities, the most important of them being the Income-Tax Officer. It is the Income-Tax Officer who comes into close contact with the assessee and who assesses their income. At top of the hierarchy, there is the Central Board of Direct Taxes which functions directly under the Ministry of Finance, Government of India.

Section 116 of the Income-Tax, Act 1961, enumerates the following classes of Income-tax authorities.

- i) The Central Board of Direct Taxes constituted under the Central Board of Revenue Act, 1963.
- ii) Directors-General of Income Tax or Chief Commissioners of Income Tax
- iii) Directors of Income Tax or Commissioners of Income Tax or Commissioners of Income Tax (Appeals)
- iv) Deputy Directors of Income Tax or Deputy Commissioners of Income Tax or Deputy Commissioners of Income Tax (Appeals)
- v) Assistant Directors of Income Tax or Assistant Commissioners of Income Tax
- vi) Assessing Officers
- vii) Tax Recovery Officers
- viii) Inspectors of Income Tax.

22.2 THE CENTRAL BOARD OF DIRECT TAXES (CBDT)

This is the highest executive authority which came into being from 1st January, 1964 in place of the Central Board of Revenue. The Board consists of a few members. The Central Government makes rules for the purpose of regulation of transaction of business by the Board. Its functions are mostly administrative and in that sphere it can modify or cancel any administrative order passed by any other authority of the income-tax department.

Powers

It has powers of administration, supervision and control over the entire income-tax department. It has powers to issue orders and directions to all officers employed in the execution of the Act but it will not interfere with the discretion of the Commissioners (Appeals) in the exercise of their appellate duties. Besides these general powers, specific powers have also been granted by the Act, some of which are given below:

- a) It can declare any association whether Indian or non-Indian, incorporated or not, to be a company for the purposes of the Act.
- b) It determines the previous year of any person or business.
- c) It can direct not to tax the income of a trust engaged in international welfare in which India has an interest.
- d) It determines the functions of the Directors of Inspection, and jurisdiction of the Commissioners and AACs.
- e) It has power to transfer cases from one AO to another.
- f) It also decides accountancy examination which a person should qualify in order to become authorised representative income-tax practitioners.
- g) It makes rules for the whole or and part of India for carrying out the purposes of this Act.

The Central Board of Direct Taxes is a body different from the Central Government. The powers given to either under the Act are quite different and distinct.

Section 19 (1) provides in unmistakable terms that every officer and person employed in the execution of the Act shall observe and follow the orders, instructions and directions of the Board. Circulars issued by the Board are generally binding on Officers and persons employed in the execution of the Act.

22.3 DIRECTOR GENERAL OF INCOME-TAX OR CHIEF COMMISSIONER OF INCOME-TAX

The Central Government may appoint such persons as it thinks fit to be the Director General or Chief Commissioner of Income-Tax.

The jurisdiction of these authorities shall be determined by the C.B.D.T. keeping in view the area, persons, incomes or cases.

- I. **FUNCTIONS:** The C.B.D.T. may by general or special order and subject to such conditions, restrictions or limitations, authorise any Director or Chief Commissioner to perform such functions of any other income-tax authority as may be assigned to him in such order.
- II. **POWERS:** The following are the important powers of the Director General or Chief Commissioner of Income-Tax.
 1. If the Central Government authorises he can appoint an income-tax authority below the rank of Assistant Commissioner.
 2. After giving the assessee reasonable opportunity of being heard in the matter after recording the reasons, can transfer the case from one Assessing Officer to the other.
 3. If he has reason to suspect that any income has been concealed or likely to be concealed by any person then he is empowered to make an enquiry.
 4. When the Director General is of the opinion that the assessee has not submitted the facts properly or fails to submit the books of accounts, etc., the Director General can order for search on buildings or place or vehicle etc. Where he has reason to suspect about their availability can seize any such books of accounts and other documents, money, bullion and jewellery etc.
 5. Requisition of Books of accounts: Where the notice has been issued to any person to produce books of account or documents, but these books of account are with other authority under any law.
 6. To make an enquiry under the Act.

22.4 DIRECTORS OF INCOME-TAX OR COMMISSIONERS OF INCOME-TAX (APPEALS)

The Central Government may appoint such persons as it thinks fit to be the Directors of Income-Tax or Commissioners of Income-Tax or Commissioners of Income-Tax (Appeals).

The jurisdiction of Commissioners or Directors is to be determined by the C.B.D.T. keeping in view the area, persons, incomes or cases.

1. **FUNCTIONS:** The Board may, by general or specific order and subject to such conditions, restrictions or limitations, authorise any Director or Commissioner to perform such functions of any other income-tax authority as may be assigned to him in such order.

The Commissioner is the practical head of the administration. He has both administrative and judicial powers. His principal powers are as under:

- a) He grants registration to a charitable and religious trust or institution.
- b) He is authorised to appoint Class II Income Tax Officers and Inspectors of Income-Tax.
- c) He issues necessary instructions for the guidance of Income-Tax Officers.
- d) He is authorised to transfer cases from one authority to another.
- e) He assigns functions to Inspectors of Income-Tax.
- f) He enforces attendance of witness.
- g) He is empowered to authorise entry, search and seizure etc.
- h) He may require books of account etc. from the custody of other authorities etc.
- i) He may make any enquiry under the Act.
- j) He may disclose any information relating to assessee.
- k) He sanctions re-opening of assessment after expiry of four years.
- l) He may authorise an Income-Tax Officer to recover arrears of tax by sale of defaulter's movable property.
- m) He may direct the ITO to prefer appeal to the Tribunal against CIT (Appeals) or AAC's order.
- n) He is also authorised to require the Appellate-Tribunal to state a case to the High Court.
- o) He can revise any order passed by a subordinate authority on application by the assessee, or on his own.

COMMISSIONERS OF INCOME TAX (APPEALS)

Commissioners (Appeals) shall perform their functions in respect of such areas or of such persons of classes or persons or of such incomes or classes of income as the Board may direct.

The powers and functions of a Commissioner (Appeals) are as follows:

- a) He may enforce attendance of persons.
- b) He may call for information from any person.
- c) He is authorised to rectify mistakes in the orders earlier passed by him.
- d) He can condone delay in filing appeals.

- e) He may admit an appeal without payment of the admitted amount of tax.
- f) He is to decide dispose of the issues raised in appeals.

The Commissioners (Appeals) are under the control of the Board. However, the Board cannot interfere with their discretion in the exercise of their appellate functions if their decisions are against the department, the department has a right of appeal to the Tribunal.

22.5 DEPUTY DIRECTORS OF INCOME-TAX OR DEPUTY COMMISSIONERS OF INCOME-TAX OR DEPUTY COMMISSIONERS OF INCOME-TAX (APPEALS)

The Central Government appoints Deputy Directors or Deputy Commissioners of Income-Tax who are subordinate to Commissioners, and Chief Commissioners.

Their area of operation is specified by the Board or any other authority so authorised. Their jurisdiction can be concurrent with other such authorities.

- I. **FUNCTIONS:** They perform such functions as are assigned to them by general or specific order issued by the Board and in respect of specific area, class of persons or specific cases or class of cases.
- II. **POWERS:**
 - (a) He is empowered to accord sanction to levy additional income-tax on companies in which public are not substantially interested.
 - (b) He may be authorised by the Board, or Chief Commissioner to exercise the powers of assessing officer.
 - (c) He has the power to cancel the registration of a firm which is not a genuine firm.
 - (d) He has the power to issue instructions to Assessing Officer to revise an order issued by I.T.O., if he has received an application from assessee regarding pending case.

Check Your Progress-I

- (a) What are the various classes of Income-Tax authorities?

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- (b) Briefly discuss the powers of Directors General or Chief Commissioner of Income-Tax?

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22.6 ASSISTANT DIRECTORS OF INCOME-TAX OR ASSISTANT COMMISSIONERS OF INCOME-TAX

The Assistant Directors or Assistant Commissioners of Income-Tax are appointed by the Central Government. They shall perform their functions in respect of such areas, persons or income which the Board may direct.

The powers and functions of these authorities are as follows:

- a) He issues instructions for the guidance of an ITO subordinate to him.
- b) He enforces attendance of witnesses and take other steps for discovery of production of evidence.
- c) If so authorised by the Commissioners, he distributes and allocates work amongst Income-Tax Officers subordinate to him.
- d) He accords approval to an ITO to make an order in relation to seized assets.
- e) He exercises the powers of survey.
- f) He may make any enquiry under the Act and exercise powers of the ITO in this respect.
- g) He may impose penalty for failure to answer questions, sign statements and allow inspection.

22.7 ASSESSING OFFICERS (INCOME TAX OFFICERS)

Assessing Officer is an authority who is approached by the assessee time and again. It is he who initiates assessment. He calls for the return of income and computes the tax payable by the assessee. He has wide powers with regard to assessment, reassessment registration of time etc. However, there is also a restraint over his authority. Most of the orders passed by him are subject to appeal to the appellate Assistant Commissioner.

Assessing Officers shall perform their functions in respect of such areas and persons, incomes and classes of incomes as the Commissioners may direct. Any assessee whose place of business is situated in the jurisdiction of an ITO will be answerable to that ITO. In case the business is conducted at more than one place, then the location of the principal place of business will decide the jurisdiction of the ITO.

Where, in respect of any proceeding under this Act, the income tax authority is transferred, the income-tax authority so succeeding may continue the proceedings from the stage at which it was left by his predecessor. But the assessee concerned may demand that before the proceeding is to be continued the previous proceeding or any part thereof be reopened or that his case may be released before any order is passed against him.

Power to Issue Summons

The ITO, AAC and Commissioner shall have the same powers as are vested in a court under the Code of Civil Procedure. The powers of the court are exercised in the following matters:

- a) Discovery and Inspection.
- b) Enforcing attendance of any person including any officer of a banking company and examining him on oath.
- c) Compelling the production of books of account and other documents.
- d) Issuing Commissions.

The ITO has power to impound and retain his custody for such period as he thinks fit, any books of account or documents produced before him any proceeding under this Act.

Search and Seizure

The Director of Inspection or the CIT and Deputy Director of Inspection may authorise the ITO for search etc. in the following cases:

- a) any person to whom summons were issued to produce books of account has omitted or failed to produce them.
- b) Any person to whom summons or notice as aforesaid has been issued or might be issued in case he has not produced any books of account or other documents which will be useful or relevant to any proceeding.
- c) When any person is in possession of any money, bullion, jewellery or other valuable article and they represent either wholly or partly undisclosed income or property.

The Officers so authorised will be within their rights in the following matters:

- i) To enter and search any building, place, person, vehicles, vessels and aircraft, where he has reason to believe that account books etc., are kept.
- ii) To break open the lock of any door, locker, safe, almirah etc, where the keys are not available.
- iii) Seize any such books of accounts, documents, money, bullion, jewellery etc. found as a result of such search.
- iv) Place marks of identification on any books of account or other documents found in the search.
- v) To make a note or any inventory of any such money, bullion, jewellery or other valuable article or thing.
- d) The CIT is empowered to authorise search and seizure irrespective of whether the person with respect of whom the search is authorised is assessed in his jurisdiction or not, if the building etc. to be searched is assessed in his jurisdiction and he considers that any delay would be prejudicial to the interests of the revenue.

Section 132 (1) mentions three conditions to be fulfilled before the authorization for carrying out the search is issued, the search would be valid only in the following cases:

- a) The Official has reasonable grounds for believing that a search is necessary.
- b) He believes that the required object cannot otherwise be obtained without undue delay.

- c) He records his reasons in writing.
- d) Where search has been authorised by one Commissioner, but some of the premises to be searched fall outside his jurisdiction, the Commissioner available locally is empowered to authorise extension of search to premises not mentioned in the search authorization issued by the first Commissioner where he is satisfied that such extension of the search is necessary.
- e) If in the course of a search, certain account books and documents are found in the premises of an assessee, it will be presumed that such assets, books of accounts etc. belong to the assessee, that their contents are true and that the signature and handwriting are of the persons who can reasonably be assumed to have signed or written the books of accounts.
- f) Summary assessment has to be made by the ITO with the previous approval of the Inspecting Commissioner.
- g) Such summary assessment should be made within a period of 120 days of the search and seizure, and he can retain such assets as would be sufficient to satisfy the existing liabilities, tax liabilities, penalty and interest payable under the IT Act.
- h) The Code of Criminal Procedure, 1937 relating to searches and seizures would be applied to searches and seizures under this Act. Materials obtained by search and seizure could be validly used for the purpose of assessment even if such search and seizure have been held to be illegal.

Power to call for information

The A.T.O., A.A.C or I.A.C. may call upon any of the following for furnishing informations:

1. A firm to furnish him with a return of the names and addresses of partners of the firm and their respective shares.
2. A hindu undivided family to furnish him with return of the names and address of the manager and the members of the family.
3. A person who is trustee, guardian or agent, to furnish him with a return of the names of the persons for whom he is a trustee, guardian or agent and their addresses.
4. A dealer, broker or agent of a stock or commodity exchange, to furnish a statement of the names and addresses of all persons on whose behalf transactions have been conducted by him.
5. An assessee, to furnish a statement of the names and addresses of all persons to whom he has paid in any previous year rent, interest, commission, royalty, brokerage and interest etc, of an amount exceeding Rs. 1,000 together with particulars of all such payments and receipts.

Power of Survey

1. The powers of survey are available to the Office of the Department including the IAC and Assistant Directors of Inspection.
2. The Income-tax authority may check cash stocks or other valuables found in the business premises.

3. The Income-tax authority may record the statement of any person in the business premises.
4. The Income-tax authority may require furnishing of information which may be useful for or relevant, to any proceeding under the Act.
5. The assessee is also required to accord facility to enable the authority to visit any other premises, besides the business premises, where the assessee states that any part of books of his account, cash, stock etc, is kept.

The Income-tax authorities are also entitled to collect information and record statements of such persons concerned at any time after an event, function or ceremony, but well before the stage of assessment proceedings in the following year if they are of opinion that having regard to the nature, scale and extent of the expenditure incurred, it is necessary to do so. This is intended to enable collection of evidence about ostentatious expenditure immediately after the event.

CHECK YOUR PROGRESS - 2

- (a) List out five important powers of an Assessing Officer.

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22.8 TAX RECOVERY OFFICERS

Tax Recovery officer may be Income Tax Officer who may be authorised by the Chief Commissioner or Commissioner by special or general order in writing, to exercise the process of a Tax Recovery Officer.

22.9 INSPECTORS OF INCOME TAX

Inspectors of Income-Tax are appointed by the Commissioner of Income Tax and they are subordinates to the A.O. They perform such functions in the execution of the Act as are assigned to them by the A.O. and other Income-tax Authority under whom they happen to work.

22.10 SUMMING UP

In this unit, we have presented the information relating to the apex body of taxes, called the Central Board of Direct Taxes and the appointment, the functions and the powers pertaining to the Director General of Income Tax, Directors of Income-Tax, Deputy Directors of Income-Tax, Assistant Directors of Income-Tax and Assessing Officers. Of all these authorities, it is the Assessing Officer who frequently comes in touch with the assessee.

22.11 CHECK YOUR PROGRESS: MODEL ANSWERS

1. (a) The Central Board of Direct Taxes, Director General or Chief Commissioner of Income-Tax, Directors or Commissioners of Income-Tax, Deputy Directors or Commissioners of Income-tax, Assistant Directors or Commissioners of Income-Tax, Assessing Officers, Tax Recovery Officers and Inspectors of Income-Tax.

- (b) He can appoint income-tax authority below the rank of Assistant Commissioner. He can transfer the case from one Assessing Officer to another. He is empowered to make any enquiry. He can seize any books of accounts, money, jewellery and other documents etc.
2. (a) (i) Discovery and production of evidence
(ii) Search and Seizure of books and other properties.
(iii) Inspect the registers of Companies
(iv) Power to call for information
(v) Power of Survey

22.12 MODEL EXAMINATION QUESTIONS

- I. Attempt the following essay questions in about 30 lines each.
1. Describe the powers of the Central Board of Direct Taxes.
 2. How is Director General or Chief Commissioner of Income-Tax appointed? What are his powers?
 3. What powers are enjoyed by the Assistant Directors or Assistant Commissioners of Income Tax?
 4. Summarise the provisions of search and seizure as stated in section 132.
- II. Attempt the following short questions in about 15 lines each.
1. State the powers of Deputy Director or Deputy Commissioner of Income-Tax.
 2. Describe the areas of administration handled by a Commissioner of Income-Tax.
 3. Explain the functions and powers of a Commissioner (Appeals).
 4. State the powers of an Assistant Commissioner of Income-Tax.
 5. What type of information can be called by the AO or the AC?
 6. What does an Inspector of Income-Tax do?
 7. Enumerate the classes of Income-tax authorities.
 8. Explain the jurisdiction of the Commissioner of Income-Tax and the Director of Income-Tax.

UNIT-23: ASSESSMENT PROCEDURE

Contents

23.0 Aims and Objectives

23.1 Introduction

23.2 General Principles

23.3 Self Assessment

23.4 Regular Assessment

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23.5.1 Compulsory Best Judgement Assessment

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23.6 Reassessment

23.7 Rectification of Mistakes

23.8 Summing Up

23.9 Check Your Progress: Model Answers

23.10 Model Examination Questions

23.0 AIMS AND OBJECTIVES

The objective of this unit is to discuss various provisions governing the assessment of Income-Tax.

On completion of this unit, you will be able to:

- * explain various provisions relating to filing of Return of Income.
- * describe the provisions of Self Assessment
- * discuss the procedure of Best Judgement Assessment
- * list out the circumstances of Reassessment

23.1 INTRODUCTION

The term 'assessment' has not been defined in the Act. However, it means computation of total income and determination of the tax liability. The procedure laid down in the Act is also include in the term. The assessment begins with the submission of the return of income by the assessee and ends up with the payment of tax by him. During the process there may be various stages which are all covered in the Act.

23.2 GENERAL PRINCIPLES

For assessment to be undertaken, there should be an assessee. It cannot be proceeded with against a non-existing person. Where it appears to the Assessing Officer (AO) that certain income has been received in the previous year by either A or B or by both of them together, it would be open to determine as to who should pay tax by initiating proceedings against him.

Return of Income [139 (1)]

Every person whose total income of the previous year exceeded the maximum amount which is not chargeable to income-tax shall furnish a return of his income voluntarily in the prescribed form (**A copy of the Return of income is given in the Appendix at the end of the book**) and get verified in the prescribed manner. For the assessment year 1992-93 this limit is Rs. 22,000. In other words, any person whose total income assessable in 1992-93 does not exceed Rs. 22,000 need not file a return of income.

The return envisaged here is a return of total income learned by an assessee for the financial year immediately proceeding the assessment year.

The due dates for filing returns of income are as follows:

- a) Where the assessee is a company - 31st December,
- b) Where the assessee is a person other than a company:
 - i) who is required to get his accounts audited - 31st October.
 - ii) deriving income from business or profession but does not fall in (i) above - 31st August.
 - iii) in any other case- 30th June.

Filing of Return of Income by Certain Salaried Taxpayers is optional [139 (1A)]

It is not necessary to furnish a voluntary return of income if the following conditions are fulfilled:

- a) If the person concerned was employed by a company was not at any time during the previous year either a director of the company or a person having substantial interest in the company.
- b) His income chargeable under the head 'Salaries' (exclusive of the value of all benefits or amenities) does not exceed Rs. 22,000.
- c) The income, if any, of the person concerned of the nature described in section 80L does not exceed the maximum amount of deduction available under that section.
- d) The tax deductible at source under Section 192 from the income chargeable under the head 'Salaries' has been fully deducted.

Return of Loss [139 (3)]

It is not the profit or income only that the assessee is required to submit in his return but it is important to submit the return when the assessee suffers loss from business or from capital assets. The benefit of carry forward and set-off will be given to the assessee only when the return of loss is submitted.

Belated Return [139 (4)]

Any person who has not submitted the return within the specified time allowed under section 139 (1) or under section 142 (1), he may furnish the return for any previous year at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

Revised Return [139(5)]

If any person having furnished a return under section 139(1) or 142(1) discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment whichever is earlier.

Defective Return

Where the A.O. considers that the return of income furnished by the tax payer is defective he is given the discretion to intimate the defect to the taxpayer and give him an opportunity to rectify the defects within a period of 15 days from the date of intimation. The A.O. may also allow extension of time for rectification of such defects. If the defect is not rectified the A.O. will treat the return as an invalid return and the provisions of the Act will apply as if the taxpayer had failed to furnish the return.

It has further been stated that the return will be treated as defective if the annexure, statements and columns in the return are not fully filled in and it is not accompanied by the following:

- a) Statement showing the computation of tax payable on the basis of return.
- b) Proof of tax deducted at source, tax paid in advance and the tax paid on the basis of self-assessment.
- c) In case the assessee is businessman and he maintains regular books of accounts, he is supposed to submit Manufacturing Account, Trading and Profit and Loss Account and Balance Sheet.
- d) Where the accounts of the assessee have been audited the audit report has also to be submitted alongwith the return.
- e) Where regular books of accounts have not been maintained, the assessee is expected to submit a statement showing the turnover, gross receipts, gross profit and expenses etc. He must also supply details of sundry debtors and creditors.

Permanent Account Number (139 A)

The income-tax department has been allotting numbers to all the assesseees which are known as Permanent Account Numbers. Everybody whose income exceeded the tax-free income limit during the previous year, has to apply to the A.O. for allotment of this number. Every person engaged in business or profession has also to apply for this if his gross turnover or gross receipts exceeded Rs. 50,000 in the previous year. The assessee has to quote such permanent account number in all his correspondence with the department and in his challan etc.

Who should sign the return (140)?

The return is to be signed and verified:

1. In the case of any individual, by the individual himself. Where he is not available or where he is of unsound mind, it can be signed by any person who is authorised to sign on his behalf.
2. In the case of HUF, by the Karta of the family. Where he is not available or where he is of unsound mind, any adult member of the family may sign it.
3. In the case of a firm by the managing partner thereof or where for any unavoidable reason such managing partner is not able to sign and verify the return or where there is no managing partner as such, by any partner thereof not being a minor.
4. In the case of a company, by the managing director thereof, or where such managing director is not able to sign, or where there is no managing director, by any director of the company;
5. In the case of a local authority, by the principal officer thereof;
6. In the case of any other association, by any member of the association or the principal officer thereof ; and
7. In the case of any other person, by that person or by some other person competent to act on his behalf.

23.3 SELF ASSESSMENT (SEC 140 A)

Under section 140 (A) it is provided that every assessee while submitting the return of income shall assess himself and pay the tax (after deducting advance tax and tax deducted at source) together with interest payable under any provision of the Act. The proof of the tax so paid should be submitted along with the return of income. Tax so paid shall be adjusted towards the tax liability as ascertained on regular assessment. In case the amount falls short of the aggregate of the tax and interest, the amount so paid shall be adjusted against tax payable.

In case assessee fails to pay the whole or any part of such tax or interest or both, he shall be deemed to be assessee-in-default in respect of the amount not paid by him.

23.4 REGULAR ASSESSMENT (ASSESSMENT ON THE BASIS OF RETURN FILED) (SEC.143(I))

Where a return has been filed by the Assessee u/s 139 or u/s 143 (I), the Assessing Officer will complete the assessment on the basis of the return. After the completion of the assessment the Assessing Officer shall send an intimation to the assessee specifying the tax or interest payable by him. If any refund is due to the assessee on the basis of such return, it shall be granted to the assessee.

In computing the tax or interest payable by, or refundable to the assessee, the following adjustments shall be made in the income or loss, declared in the return, namely:

- a) Any arithmetical errors in the return, accounts or documents accompanying it, shall be rectified:
- b) any loss carried forward, deduction, allowance or relief which is prima facie admissible but which has not been claimed in the return shall be allowed; and
- c) any loss carried forward, deduction, allowance or relief claimed in the return which is prima facie inadmissible, shall be disallowed.

In case any adjustment is made by Assessing Officer an intimation to this effect must be sent to assessee even if no tax or interest is found due from him as a result of such adjustment.

Sometimes the Assessing Officer feels that the return is not supported by adequate documents and he wants further support of evidence to substantiate certain details. Then he issues a notice u/s 143 (2) to the assessee to furnish documents and produce evidence. The assessee is obliged to send all such details.

No notice under this sub-section shall be served after the expiry of the financial year in which the return is furnished or the expiry of six months from the end of the month in which the return is furnished, whichever is later.

Once all such documents are furnished by the assessee, the Assessing Officer will complete the assessment after going through all such documents and satisfying himself to the correctness thereof.

Levy of Additional Income-Tax

An additional income-tax will be levied of an amount equal to 20 percent of the tax payable on the amount of difference between the total income determined under section 143(1) and the total income declared in the return. In case any refund is due, the amount of such refund shall be reduced by an amount equivalent to the additional income-tax so calculated.

Check Your Progress - 1

What do you mean by Self Assessment and Regular Assessment?

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23.5 BEST JUDGEMENT ASSESSMENT

There are situations when the assessee neither complies with the provisions of the Income-Tax Act nor does he comply with the notice issued by the Assessing Officer. In such a case, the Assessing Officer is left with no choice except assessing the person ex-parte. Assessing the person ex-parte is also known as Best Judgement Assessment.

In this type of assessment the Assessing Officer proceeds with the finalisation of income or loss of the assessee according to the best of his ability, knowledge, judgement, guess work etc. The idea of this type of assessment is not to punish the assessee for his non-cooperation, but to make the assessment on the basis of the available information. However the AO should not rely on hearsay evidence and his private opinion should not override the honest estimate. He must decide the case according to law, rules of reason and justice.

The best judgement assessment is of two types:

- a) Compulsory Best Judgement Assessment
- b) Discretionary Best Judgement Assessment

23.5.1 COMPULSORY BEST JUDGEMENT ASSESSMENT (SEC.144)

A compulsory best judgement assessment shall be made, if any person:

- i) fails to file the return u/s 139; or
- ii fails to comply with the notice issued u/s 142(i);or
- iii) fails to comply with the directions issued u/s 142 (2A) regarding audit of his accounts;
- iv) fails to comply with the notice issued u/s 143 (2) to give evidence in support of his return.

U/s 144 the AO shall make the assessment to the best of his judgement after taking into account all relevant material which he had gathered and after giving the assessee an opportunity of being heard.

Consequences

Along with best judgement assessment, the assessee will also face the following consequences:

- i) If the assessee is a firm, the AO may refuse to register the firm for that previous year or if the firm is already registered, the same may be cancelled.
- ii) Where the assessee is a company in which public are substantially interested, such company would lose the right of declaring dividend to escape the additional Income-Tax.
- iii) When the assessee files an appeal against the best judgement assessment, he is prevented from bringing on record any new facts before the appellate authorities.

In addition to these consequences, the assessee becomes liable for penalties and prosecutions.

Remedies

The assessee has only two remedies against compulsory best judgement assessment. These are:

- i) Filing of an application with the AO for the cancellation of best judgement assessment.
- .ii) Filing of an appeal against such assessment with the higher authority.

23.5.2 DISCRETIONARY BEST JUDGEMENT ASSESSMENT [(SEC.145(2))]

Discretionary best judgement assessment may be made under the following two types of cases:

- i) Where AO is not satisfied with the correctness or the completeness of the accounts of the assessee; or
- ii) Where no method of accounting has been regularly employed by the assessee.

Under these circumstances it is upto the discretion of the AO whether to make a best judgement assessment or a regular assessment u/s 143 (3). But once this type of assessment is made, the assessee will have no option but to file an appeal with the higher authority.

Check Your Progress - 2

What is Best Judgement Assessment? What are its kinds?

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23.6 REASSESSMENT OR INCOME ESCAPING ASSESSMENT (SEC.147)

It is possible that while assessing a person, he might have been underassessed or certain incomes might have escaped attention of the Assessing Officer. This type of lacuna is taken care of by the provision of a re-assessment provided u/s 147. Reassessment is possible under the following circumstances:

- a) Where an assessment has been made, but income chargeable to tax has been underassessed or assessed at too low a rate or any excessive loss or relief or depreciation allowance or any other allowance has been allowed.
- b) Where no return of income has been furnished by an assessee although total income exceeded the maximum amount which is not chargeable to tax.
- c) Where a return of income has been furnished but no assessment has been made and the assessee is found to have understated his income or claimed excessive loss, deduction, allowance or relief in the return.

Once an assessment has been reopened, any other income which has escaped assessment and which comes to the notice of the A.O. subsequently in the course of the proceeding u/s 147 can also be included in the assessment. If an assessment has been made for the relevant assessment year u/s 143 (3) or u/s 147 no action shall be taken u/s 147 after the expiry of four years from the end of the relevant assessment year unless the income has escaped assessment due to the failure on the part of the assessee to file a return u/s 139 or 142 (1) or 148 or to disclose fully and truly all material facts necessary for his assessment. Before making the reassessment u/s 147 the A.O. shall serve on the assessee, a notice requiring him to furnish a return of income of within such period (not being less than 30 days) as may be specified in the notice. The reassessment shall be made within the period prescribed under sections 149 and 151.

23.7 RECTIFICATION OF MISTAKES

There are possibilities of mistakes being committed by the income-tax authorities. The law has provided a detailed scheme for rectification either at the instance of the assessee or on his own motion.

The order for rectification of mistakes shall be in writing and where it effects the assessee adversely he shall be given an opportunity of being heard in the matter. But where the rectification of mistake results in the reduction of tax liability, the authority concerned will make a refund to the assessee. Amendment under this section can not be done after the expiry of four years from the order sought to be amended. The important element leading to rectification is the mistake apparent from record when it is obvious or self evident. The A.O. will not be given an opportunity to rectify when there is no fresh information or when the mistake is not apparent from record.

Rectification of Mistake not on Record (155)

Section 155 gives a list of cases where there are no mistakes apparent from the record but the A.O is empowered to make amendments in the order of assessment and his action is deemed to be rectification of mistake.

23.8 SUMMING UP

The assessment begins with the submission of the return of income by the assessee. The various assessment procedures discussed in the unit are: Self assessment, Regular assessment, Best judgement assessment and reassessment. Every assessee while submitting the return of income shall assess himself and pay tax accordingly. On the basis of the return filed by the assessee, the Assessing Officer completes the assessment. This is known as Regular assessment. In certain situations the assessing officer may assess the person ex-parte. It is known as Best Judgement Assessment. It is of two types. They are: (1) Compulsory best judgement assessment and (ii) Discretionary best judgement Assessment. Sometimes an assessee may be underassessed or certain incomes may be understated. In such a situation reassessment is made.

23.9 CHECK YOUR PROGRESS: MODEL ANSWERS

1. An assessee assesses himself and pays tax accordingly while filing the return of income. This is known as self assessment.

On the basis of the return filed by the assessee, the Assessing Officer completes the assessment. This is known as regular assessment under Section 143 (1)

2. In certain situations the Assessing Officer finalises the assessment according to his knowledge and judgement. Here, he assesses the person ex-parte. This is Best Judgement Assessment. It is of two types i.e. (1) Compulsory best judgement assessment and (ii) Discretionary best judgement assessment.

23.10 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following questions in about 30 lines each:

1. Describe the provisions of regular assessment.
2. What is a defective return? How do you remove the defect? Explain the consequences when the defect is not removed?
3. Explain the provisions of Income Escaping Assessment.
4. When is Compulsory Best Judgement Assessment resorted to? Explain the consequence of such an assessment.

II. Short Questions

Attempt the following short questions in about 15 lines each.

1. When is filing of a return of income optional?
2. Who is required to sign a return of income?
3. Explain the purpose of a Permanent Account Number.
4. Describe the provisions of self assessment. When is rectification of mistakes possible?
5. Explain the best judgement assessment.

UNIT-24: APPEALS AND REVISION

Contents

24.0	Aims and Objectives
24.1	Introduction
24.2	Appeal to the Deputy Commissioner (Appeals)
24.3	Appeal to the Commissioner (Appeals)
24.4	Appeal to the Appellate Tribunal
24.5	Appeal to High Court (H.C.)
24.6	Appeal to Supreme Court (S.C.)
24.7	Revision by the Commissioner of Income Tax
24.8	Summing Up
24.9	Check Your Progress: Model Answers
24.10	Model Examination Questions

24.0 AIMS AND OBJECTIVES

The objective of this unit is to discuss all the provisions relating to appeal for revision of income-tax.

After going through this unit, you should be able to:

- * list out the orders of A.O. against which the assessee can appeal to the DC(A) and to the Commissioner (Appeals)
- * explain, how appeals are made to the Appellate Tribunal
- * discuss the provisions relating to an appeal to H.C. and S.C.
- * describe the revisions made by the Commissioner of Income - Tax.

24.1 INTRODUCTION

The right to appeal to the higher authorities or court is a part of natural justice and therefore it is natural that the Income-Tax Act should provide such a right to the assessee. There are many occasions when the Assessing Officer passes many orders which go against the interest of the assessee. He will, therefore, seek justice by approaching higher authorities.

It is an accepted fact that the right of appeal is a part of natural justice. However, the right to appeal is not available to the aggrieved party automatically unless the relevant status grant it specifically. The Income Tax Act 1961, contains an elaborate scheme of appeals and revisions. The assessee may go in appeal to the Deputy Commissioner (Appeals) against the order of the

Assessing Officer. In case he has inclination to go in appeal he may go to the Commissioner of Income-Tax for seeking revision of the order of the Assessing Officer.

24.2 APPEAL TO THE DEPUTY COMMISSIONER (APPEALS)

The assessee is granted the right to appeal to the Deputy Commissioner (Appeals) against the following orders of the Assessing Officer (other than the Deputy Commissioner)

- a) an order against assessee where denies liability to be assessed or order u/s 143 (3) or 144 where assessee objects to amount of income assessed or amount of tax determined or amount of loss computed or status under which he is assessed.
- b) an order or assessment or reassessment or recomputation u/s 147 or 150.
- c) an order of rectification of mistake enhancing the tax liability or reducing the refund.
- d) an order of treating the assessee as the agent of non-resident.
- e) an order of making the assessee liable in respect of his predecessor's tax liability.
- f) an order relating to the assessment after partition of a Hindu Undivided Family.
- g) an order of refusing registration or cancelling the registration of a firm.
- h) an order of treating a person as an assessee-in-default.
- i) an order relating to the interest payable by the assessee as a result of under payment of advance tax.
- j) an order imposing penalty for various defaults on the part of the assessee.

An appeal by a company-assessee, in the aforesaid cases, lies with the Commissioner (Appeals). Moreover, in the case of a non-corporate assessee the first appeal lies with the Commissioner (Appeals), if the amount of income assessed or loss computed exceeds Rs. 1,00,000.

24.3 APPEAL TO THE COMMISSIONER (APPEALS)

In the following cases first appeal against the order of the A.O. lies with the Commissioner (Appeals), and not with the D.C.(A).

- a) Any order given under the appealable orders to D.C.(A), where such order is made by Deputy Commissioner.
- b) An order against a closely-held company imposing additional income-tax on it.
- c) An order imposing penalty made by a Deputy Commissioner.
- d) An order of assessment made on the basis of directions issued by the Deputy Commissioner u/s 144 A.

- e) An order imposing penalty by the A.O. with the previous approval of the Deputy Commissioner.
- f) An order, made by the Deputy Commissioner, relating to rectification of mistake.
- g) An order imposing a penalty on account of failure to get accounts audited.
- h) An order made by an A.O. in cases which the Board may direct.

Procedure for Filing Appeal

The appeal shall be presented within 30 days of the receipt of the order against which appeal is preferred. It shall be in the prescribed form. The D.C.(A) or Commissioner (A) after hearing the assessee and the Income-Tax Department, is required to pass his order in writing. The order should be communicated to the assessee and the Commissioner of Income Tax.

Powers of D.C.(A) or Commissioner (Appeals)(Sec.251)

In disposing of the appeal, the D.C.(A) or the Commissioner (Appeals) has following powers:

- i) In an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment or he can set aside the assessment and refer the case back to the A.O. for making fresh assessment in accordance with the direction given by him.
- ii) In an appeal against an order imposing a penalty, he may confirm, or cancel such order or make a variation in the amount of penalty.
- iii) In any other case, he can pass such orders as he thinks fit.

24.4 APPEALS TO THE APPELLATE TRIBUNAL

Appellate Tribunal is the final fact finding body. On facts whatever it says is final and no appeal lies anywhere else on matter of facts. The Appellate Tribunal is the second court of appeal.

If the assessee is not satisfied with the order of the D.C.(A) or Commissioner (A), he may prefer an appeal before the Appellate Tribunal. Similarly if the A.O. is not satisfied with the order of the D.C.(A) or Commissioner (A), he may, with the approval of the Commissioner of Income-tax, file an appeal before the Appellate Tribunal.

The Central Government shall constitute an Appellate Tribunal to hear appeals against the orders of the D.C.(A) or the Commissioner (Appeals). It consists of judicial and accountant member. The judicial member acts as president. There are many benches of the Tribunal scattered all over the country. In Bombay alone there are four benches.

Every appeal to the Appellate Tribunal shall be filed within 60 days of the date of the order sought to be appealed against. An appeal to the Tribunal shall be in the prescribed form and be verified in the prescribed manner and shall be accompanied by a fee of Rs. 200. If the appeal is preferred by the Department, fee is not paid. The parties are heard by the Tribunal and orders passed. The decision is the majority decision. In case two members hearing the case hold different views the matter is referred to the President who appoints another member to hear the whole case. After taking his views into account majority decision prevails.

The Tribunal is the final fact finding body. The courts therefore, will not interfere with its working. On point of law, the parties may suggest to the Tribunal to refer the case to the High Court. If the point involved is quite important on which different High Courts hold different views, the Appellate Tribunal may refer the case directly to the Supreme Court for its verdict in the matter. This is done with a view to putting a stop to the different rulings and the consequent confusion.

Check Your Progress - 1

Who can appeal to the Appellate Tribunal?

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24.5 APPEAL TO HIGH COURT

On getting the decision of the Tribunal, either of the aggrieved parties may apply to the Appellate Tribunal to prepare a statement of the case and refer the questions of law to the High Court for its decision. This application shall be accompanied by a fee of Rs. 200. The Commissioner is not required to pay this amount. If the Appellate Tribunal refuses to state the case on the ground that no question of law arises, the assessee or the Commissioner may apply to the High Court. The High Court, if satisfied with the contention of the party that there does arise a question of law, may direct the Appellate Tribunal to prepare a statement of the case and forward it for decision. The High Court upon hearing any such case should decide the questions of law raised therein.

24.6 APPEAL TO SUPREME COURT

If any of the parties to the dispute is not satisfied with the judgement delivered by the High Court, there is a provision for going to the Supreme Court. For going to the highest Court of the land, the affected party may request the High Court to give it a certificate that the dispute is a fit case to be decided by the Supreme Court. Some times the High Court may not agree with the contention of the party that the case be referred to the Supreme Court for final decision in the matter. In such circumstances, the affected party may go to the Supreme Court directly and convince that the case is worth hearing. Where the Supreme Court agrees that the case is worth hearing by them, the Court may direct the High Court to refer the case to it. The High Court shall then send the reference to the Supreme Court. Any judgement given by the Supreme Court shall be carried out by the Department and the assessment shall be completed on the lines given by the highest Court of the land. This is the final verdict.

24.7 REVISION BY THE COMMISSIONER OF INCOME - TAX

The Commissioner may call for and examine the record of any proceeding under this Act. If he considers that any order passed by the Assessing Officer is erroneous and prejudicial to the revenue, he may make further enquiries in the matter and revise such order. If the revision results in enhancement of tax liability, the assessee is given reasonable opportunity of being heard in the matter. The assessee is also entitled to apply to the Commissioner, for revision of some of orders of the A.O. But this is done when the assessee does not prefer any appeal to the appellate authority.

The power of revision under section 263 can be exercised only if the following conditions are satisfied. Firstly, the Commissioner must call for and examine the records of the proceedings under the Act. Secondly the Commissioner must consider the order passed by the A.O to be erroneous in so far as it is prejudicial to the interest of revenue.

Necessary Conditions

- a) No order shall be passed after the expiry of two years from the end of the financial year in which the order sought to be revised was passed.
- b) There should be a proceeding under the Act and in such proceeding the A.O. must have passed an order which according to the Commissioner is erroneous and prejudicial to the interests of the Revenue.

Revision of Other Orders

The Commissioner is also competent to revise orders passed by the Assistant Commissioner or Deputy Commissioner. He is also authorised to revise orders of such authorities when they are brought to the notice of the Commissioner by the assessee. On his own too he may call for such records for revision. Where the Commissioner wants to revise orders under this section, the time limit is one year from the date of order sought to be revised. Where the assessee has to approach the Commissioner for revision he should do so within a year of the service of order sought to be revised.

The Commissioner has a right to make enquiries and pass such orders as he thinks fit. However, any order prejudicial to the assessee can be passed only after a suitable opportunity has been provided to him to defend himself.

Every application for revision by the assessee shall be accompanied by a fee of Rs. 25.

Check Your Progress - 2

- i) Who has the power to revise the orders of AO, Deputy Commissioner?
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- ii) List out the powers of Commissioner of Income-Tax regarding revisions.
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24.8 SUMMING UP

The assessee has a right to appeal to the higher authorities against the orders passed by A.O. There are various such orders against which we can appeal to the Deputy Commissioner (Appeals) or Commissioner (Appeals). They have certain powers to dispose of these appeals. If the assessee is not satisfied with the order of DC(A) or Commissioner (A), he can appeal to the Appellate Tribunal. It is the final fact finding body. On getting the decision of the Tribunal,

the case may also be referred to High Court and from there to the Supreme Court. Finally, it is the Commissioner of Income-Tax who can revise the orders passed by the different authorities.

24.9 CHECK YOUR PROGRESS: MODEL ANSWERS

1. If the assessee or A.O. is not satisfied with the order of D.C.(A) or Commissioner (Appeals) they can appeal to the Appellate Tribunal.
2.
 - i) The Commissioner of Income-tax
 - ii)
 - i) To examine the record of any proceeding under the Act.
 - ii) To enquire and revise orders passed by the A.O.
 - iii) To revise orders passed by Assistant Commissioner or Deputy Commissioner.

24.10 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Answer the following questions in about 30 lines each.

1. Enumerate the appellate orders go to the D.C(A)
2. What do you mean by the Income-Tax Appellate Tribunal? What type of appeals should go there?
3. How is reference to the High Court or Supreme Court preferred?
4. Describe in full the provisions relating to revision by the Commissioner of Income-Tax.

II. Short Questions

Answer the following in about 15 lines each

1. Under what circumstances the assessee is required to go to the Deputy Commissioner (Appeals)?
2. When should an assessee go to the Appellate Tribunal?
3. How is reference to the Supreme Court made?
4. What is revision? Who does it?
5. What type of orders are revised by the Commissioner on his own?
6. Describe the procedure for filing an appeal before the Appellate Tribunal.
7. How is reference to High Court preferred?
8. What are the powers of D.C(A), Commissioner (Appeals) in disposing an Appeal?

UNIT - 25: COLLECTION OF TAX

Contents

- 25.0 Aims and Objectives
- 25.1 Introduction
- 25.2 Deduction of Tax at Source
- 25.3 Advance Payment of Tax
- 25.4 Refund
- 25.5 Recovery of Tax
- 25.6 Summing Up
- 25.7 Check Your Progress: Model Answers
- 25.8 Model Examination Questions.

25.0 AIMS AND OBJECTIVES

In this unit we propose to explain various methods of collection and recovery of tax from the assessee. In addition 'Refunds' are also explained.

On completion of this unit, you should be able to:

- * explain the rationale of deducting tax at source;
- * describe the procedure for recovering tax.

25.1 INTRODUCTION

The tax on total income is collected in three ways.

- i) Deduction of tax at source;
- ii) Advance payment of tax; and
- iii) Tax on assessment.

The last method i.e. tax on assessment has already been discussed in unit 23 entitled 'Procedure for Assessment'. Therefore, the remaining two methods i.e., deduction of tax at source and advance payment of tax are discussed in this chapter along with 'Refunds' and Recovery of tax.

25.2 DEDUCTION OF TAX AT SOURCE

So as to reduce the cases of tax evasion, the Income-Tax Act has made provisions to collect tax at source in certain specified cases of income at the time when the income earner receives them. Under this scheme, persons deduct tax at source and deposit the same with the

Government's treasury within the stipulated time. The recipient of income-though he gets only the net amount-is liable to tax on the gross amount and the amount deducted at source is adjusted against his final tax liability.

The specified cases of income, where tax is deducted at source are: salaries, interest on securities, dividends, interest other than interest on securities, winnings from lotteries, crossword puzzles and horse races, payments to contractors, insurance commission, payments in respect of National Savings Scheme, payments on account of repurchase of units of mutual funds or UTI, and also on other source chargeable under the Act which are paid to non-residents. The provisions of the Act, in each case, are given below:

Salaries (Sec 192)

Any person responsible for paying any income chargeable under the head 'salaries' is required to deduct tax at source on the amount payable. Tax is to be calculated at the rates prescribed for the financial year in which the payment is made on the estimated income of the assessee under this head of that financial year. While estimating income under this head the amounts deductible under sections 80 CCA, 80 CCB, 80D, 80DD, 80G[certain payments only], 80GG, 80RRA, 80U and relief u/s 89 (1) (in certain cases) should also be considered.

Where a person is employed simultaneously under more than one employer, or where he has held successively employment under more than one employer, the tax at source shall be deducted by an employer (as the assessee may choose) from the aggregate salary of the employee for the year.

Where an employee is having income under any other head of income he can furnish details of his other incomes to this employer and the employer can deduct tax at source for such incomes also. But the assessee has no right to claim the set off of any loss from any other head.

The person responsible for paying salary may, at the time of deducting tax at source, increase or decrease the amount to be deducted for the purpose of adjusting any previous deficiency or excess deduction. The employer has no right to negotiate with any employee, whereby arrangement the employee has undertaken to discharge his tax liability. No tax is required to be deducted at source, unless the estimated salary exceeds the maximum exemption limit specified for that financial year.

Interest on Securities (Sec.193)

The person responsible for paying interest on securities is liable to deduct income-tax at the time of paying the interest at the rates specified by the Finance Act of the year. However, no tax is deductible at source from the amount of interest payable on a) $4\frac{1}{4}$ percent National Defence Bonds 1972, held by any resident individual; b) $4\frac{1}{4}$ percent National Defence Loan, 1968 or $4\frac{3}{4}$ percent National Defence Loan, 1972 held by an individual; c) National Development Bonds; d) National Savings Certificates (First issue); e) 7-year National Savings Certificates (2nd issue), f) debentures issued by any co-operative society or any other institution or authority notified by the Central Government; g) $6\frac{1}{2}$ percent Gold Bonds, 1977 or 7 percent Gold Bonds, 1980 held by a resident individual (provided the conditions specified in section 193 are fulfilled); h) notified securities of the Central/State Governments; i) any other security of the Central or State Governments held by a resident provided the conditions in section 193 are satisfied; j) Debentures issued by a widely-held company, which are listed on a recognised exchange in India, provided the interest is paid by the company by an account payee cheque and the amount of such interest paid or likely to be paid during the financial year by the company to such individual does not exceed Rs. 2,500.

No deduction of tax is made from interest on securities, in the case of a resident individual if he furnishes a declaration in Form No. 15 to the payer of such income.

Dividends (Sec.194)

The principal officer of a domestic company is required to deduct tax at source from the amount of dividend to be distributed to a shareholder who is a resident in India at the prescribed rate.

No deduction of tax is made from the dividend.

- a) If the shareholder obtains a certificate from the concerned Assessing Officer, authorising the payer to pay dividend without deduction of tax at source, then no deduction of tax is made from dividends.
- b) In case of a resident individual, if he furnishes a declaration in Form No. 15G to the payer of such income.
- c) It is not necessary to deduct tax from dividend income paid by a company (in which public are substantially interested) to a shareholder, being an individual who is resident in India, if i) the dividends are paid by such company by an account payee cheque; and b) the amount of such dividend distributed or paid or likely to be distributed or paid during the financial year does not exceed Rs. 2,500.

Interest other than interest on securities (Sec 194 A).

Any person, not being an individual or a Hindu undivided family, who is responsible for paying interest other than interest on securities (in excess of Rs. 2,500) to resident during the financial year is required to deduct income-tax thereon at the rates in force. However, no tax is deductible at source where the person, not being a company or registered firm, has furnished an affidavit declaring that his estimated total income during the year in which the income is credited or paid will be less than the minimum income liable to income-tax. Moreover, no deduction of tax will be made in the case of a resident individual if he furnishes a declaration in Form No. 15H to the payer of such income.

It is also open to the recipient to obtain certificate, from the concerned Assessing Officer, authorising the payer to deduct tax at lower rates or deduct no tax at all.

Winning from Lotteries or Crossword Puzzles (Sec.194B)

A person responsible for paying to any person any income by way of winnings from lotteries or crossword puzzles exceeding Rs. 5,000 is required to deduct income tax at the time of such payment at the rates in force, where the prize is given partly in cash and partly in kind, the entire tax will be deducted from cash prize. If the prize is given only in kind, no tax is required to be deducted.

Winnings from horse races (Sec.194 BB)

A person responsible for paying to any person any income by way of winnings from horse races exceeding Rs. 5,000 (Rs.2,500 from October, 1991) is required, at the time of such payment, to deduct income-tax thereon at the rates in force.

Payments to Contractors (Sec.194C)

A person responsible for paying any sum to a resident contractor in pursuance of a contract with the Central Government or any State Government or any local authority or any corporation

or any company or any co-operative society is required to deduct tax at source at the rate of 2 percent from such payment. Likewise, a contractor, other than an individual or a Hindu undivided family, is required to deduct tax at source at the rate of 1 percent from any sum paid to any sub-contractor.

However, no tax is to be deducted at source in respect of a contract, the consideration for which does not exceed Rs. 10,000. It is open to the recipient to obtain a certificate, from the concerned Assessing Officer, authorising the payer to deduct tax at lower rates or deduct no tax.

Insurance Commission (Sec.194 D)

Tax at source will be deducted by any person responsible for paying to a resident, any income by way of remuneration or reward, whether by way of commission or otherwise for soliciting or procuring insurance business if such payment exceeds Rs. 5,000 in a financial year.

Payments in respect of National Savings Scheme (Sec.194 E)

The person responsible for paying any amount from National Savings Scheme is required to deduct income-tax thereon at the rate of 20 percent if such payment exceeds Rs. 2,500 in a financial year. However, no such deduction shall be made if the payment is made to the heirs of the deceased depositor or if the recipient furnished a declaration to paying authority.

Payments on account of purchase of units of Mutual funds or UTI (Sec 194 F).

At the time of repayment of units of UTI or Mutual Funds on which a deduction u/s 80 CCB was claimed, a tax at 20 percent shall be deducted as source.

Any other sums (Sec.195)

Any person responsible for paying to a non-resident not being a company or to a foreign company, any interest (not being Interest on Securities) or any other sum (not being dividend), shall at the time of payment deduct income-tax at the prescribed rates for that year. No tax shall be deducted at source in case the assessee furnishes a prescribed certificate granted by the concerned Assessing Officer.

When tax is not to be deducted at source (Sec.196)

No tax shall be deducted at source by any person on interest or dividend payable to (i) The Government; or (ii) the Reserve Bank of India; or (iii) a Corporation or (iv) a Mutual Fund.

Consequences on Failure to Deduct or Pay (Sec.201)

Any person responsible for deduction of tax at source fails to do so or after deducting fails to deposit such a tax into the Government treasury, would be deemed to be an assessee in default in respect of the tax and would be personally liable to pay tax as well as penalty which may be imposed.

Check Your Progress - I

- (a) What are the various ways in which the tax is collected on the total income?

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- (b) Why is tax deducted at source? What are the various circumstances under which tax is deducted at source?

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25.3 ADVANCE PAYMENT OF TAX

The scheme of advance payment of tax is also known as 'pay as you earn scheme'. This means that an assessee has to pay tax in advance in a particular financial year on his estimated income which is to be taxed in the assessment year immediately following. For example, the advance tax payable during the current financial year 1992-93 is on the estimated taxable income to be taxed in the assessment year 1993-94. A separate schedule of rates of tax is specifically provided in the annual Finance Act every year according to which tax is to be computed for payment in advance. From the tax so computed, tax deducted at source will be deducted.

When a person becomes liable to pay advance tax (Sec.208)

Every person is liable to pay advance tax if advance tax payable is Rs. 1,500 or more. All items of income including capital gains, winnings from lotteries, cross word puzzles etc, are liable for payment of advance tax.

Computation of Advance Tax

Advance tax liability is computed as follows.

Rate structure for computing Advance Tax during Financial Year 1992-93:

In the Case of individuals:

Rates of Income Tax:

1.	First Rs. 28,000 of total income	Nil
2.	Next Rs. 22,000 of total income	20%
3.	Next Rs. 50,000 of total income	30%
4.	Balance of total income over Rs.1,00,000	40%

In respect of individuals having total income exceeding Rs. 1,00,000/- income tax will be calculated as per the above rates; then rebate under Sec.88 and 88B will be allowed. On the balance, Surcharge @ 12% is to be added.

Payment of advance tax by the assessee on his own account

An assessee who is liable to pay advance tax is required to estimate his current income and pay advance tax thereon without submitting any statement of income to the assessing authorities. After making payment of first, second instalments of advance tax on assessee can revise the remaining instalment(s) of advance tax in accordance with his revised estimate of current income and pay tax accordingly.

Payment of advance tax in pursuance of order of Assessing Officer

If the assessee fails to pay advance tax, the Assessing Officer may pass an order, requiring him to pay advance tax on his current year's income, before the end of February of the financial year. On receipt of the notice from the Assessing Officer the assessee can submit his own estimate of lower current income/advance tax and pay tax accordingly. If the advance tax on current income as per assessee's own estimate is higher than the amount estimated by the Assessing Officer, the assessee shall pay higher tax in accordance with his own calculation.

Computation of tax by Assessing Officer

The total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment or the total income returned by the assessee in any return of income furnished by him for any subsequent previous year, whichever is higher, shall be taken as current income by the Assessing Officer and the tax on it is computed at the rate in force during the financial year.

Payment of advance tax in pursuance of revised order of Assessing Officer

The order passed by the Assessing Officer to pay advance tax can be revised by him u/s 210 (4) if subsequent to the making of an order to pay advance tax but before March 1st of the relevant financial year, a return of income in respect of any later year has been furnished or any assessment for any later year has been completed at higher figure. On receipt of revised order the assessee will have to pay advance tax accordingly. However, the assessee can submit his own estimate of lower current income/advance tax and pay tax accordingly. In such a case he has to send an intimation to the Assessing Officer.

Instalments of advance tax

Advance tax is payable in three instalments during the financial year. Upto 30 percent, 60 percent, 100 percent of the advance tax payable shall be paid by September 15, December 15, and March 15 respectively. However, any payment of advance tax made before March 31 shall also be treated as advance tax paid during the financial year.

Interest payable by Government

In case any assessee pays advance tax more than the amount of assessed tax determined on regular assessment, the Central Government, shall pay simple interest at 15 percent to such assessee on the above said excess payment of advance tax. Such interest shall be calculated from 1st April next following the said financial year to the date of regular assessment. The interest so paid to the assessee is liable to tax as income.

Interest payable by assessee

The assessee has to pay simple interest at 15% in case his estimate of income turns out to be too low and advance tax paid is less than 75 percent of assessed tax.

Assessee deemed to be in default

The assessee is deemed to be in default if he does not pay on the due date any instalment of advance tax that he is required to pay by an order of the Assessing Officer.

Check Your Progress - 2

When does the Government pay interest to the assessee?

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25.4 REFUNDS

Refund means "to pay back". Refund arises when the tax paid by an assessee is more than the actual tax payable on his income in respect of an assessment year. Refund may arise due to (i) excess deduction of tax at source; (ii) by excess payment of advance tax (iii) excess payment of tax under self-assessment; (iv) reduction in tax liability as a result of appeal or revision (v) grant of double taxation relief.

Who can claim refund (Sec.238)

Generally, refund can be claimed only by a person who has made excess payment of tax. Where the income of one person is included in the total income of any other person, the latter alone would be entitled to a refund in respect of such income. Again, if due to death, incapacity, insolvency or some other reason, a person is unable to claim a refund due to him, his legal representative or guardian or receiver is entitled to claim or receive such refund.

How to claim refund

Every claim for the refund has to be made in the prescribed form (Form No.30) and in the prescribed manner. The claim should be accompanied by a return of income if the claimant has not furnished such a return earlier. If the total income of the claimant consists of interest on securities, dividends etc., from which income-tax has been deducted at source, the claim should be accompanied by the certificate for such deduction.

The claim of Refund should be made within two years from the last day of the relevant assessment year. However, this time limit does not apply to such cases where the refund becomes due to the assessee as a result of an order passed by any of the appellate authorities. In such a case the assessee is not required to file any formal application. The Income Tax Officer is bound to grant refund suo moto.

Note: The period for claim up refund is reduced to one year w.e.f the A.Y.1993-94.

Power to withhold Refund in certain cases (Sec.241)

In the case where (i) a notice has been issued u/s 143(2); or (ii) an order giving rise to refund is the subject matter of an appeal; or (iii) any other proceedings are pending under this Act, the Assessing Officer may withhold the refund if he feels that the grant of refund may adversely affect the revenue. But while doing so, he must obtain the previous approval of the Commissioner or Chief Commissioner.

Interest on refund

Where refund is of any advance tax or tax collected at source, the interest is payable at the rate of one percent (1.5 per cent upto September 30, 1991) per month or part of the month from the first day of the assessment year to the date of grant of refund. However, no interest is payable if the excess payment is less than 10 percent of tax determined on regular assessment.

Where refund is of tax other than advance tax or tax collected at source, interest is payable at the rate of 1 per cent (1.5 percent upto 30.9.1991) per month or part of month from the date of payment of such tax upto the date on which the refund is granted.

Set-off of Refunds against Outstanding Tax (Sec.245)

Where a refund is due to an assessee in respect of a particular assessment year and at the same time there is a sum by way of tax, penalty etc., due from him in respect of some other assessment year, the tax authorities may, in lieu of refund set-off the amount to be refunded against the sum due from the assessee.

25.5 RECOVERY OF TAX

The tax liability of an assessee in respect of the income of a particular year is determined when the regular assessment is made. If the aggregate amount of the tax collected at source, advance payment of tax and tax paid under self-assessment falls short of the tax payable on regular assessment, the Assessing Officer will issue a demand notice for the balance. The assessee is required to pay the tax demanded within the stipulated time. Payment may also be made in instalments by the assessee if prior approval of the AO is obtained. If the assessee fails to pay the tax within the stipulated time, he is treated as an assessee in default. He will then be liable for interest and penalty.

Modes of Recovery (Sec.222)

Where an assessee is in default, the Tax Recovery Officer (TRO) shall draw up a statement specifying the amount due from the assessee, and shall proceed to recover the amount by any of the methods given below:

- i) Attachment and sale of assessee's movable and immovable property.
- ii) Appointing a receiver to take over the charge of assessee's movable and immovable property.
- iii) Issuing orders for the arrest of the assessee.
- iv) If the assessee is an employee, the TRO may approach the person paying salary to deduct arrears of tax from salary of the assessee and pay the same to the Government.
- v) If a person owes any amount to the assessee, the TRO may ask such person to pay the amount to the Government to cover the arrears of the tax due from the assessee.
- vi) The TRO may also apply to the court in whose custody there is any money belonging to the assessee for payment of such money to discharge the tax liability.

Recovery through State Government (Sec.227)

If the recovery of tax in any area has been entrusted to a State Government, it may direct that the tax will be recovered from the assessee in respect of that area along with other local taxes due from him. Such tax shall be collected according to the law prevailing in that area.

25.6 SUMMING UP

In this unit, we have dealt with the specified cases of income which are subject to tax at source. Further, we have discussed the concept of 'Advance payment of Tax', its computation and the method of its payment. The circumstances warranting the refund of tax, the persons who are entitled to claim such refund, the method of claiming refund, the situation where interest is calculated on the grant of refund etc., are also explained exhaustively. Finally, we have examined the recovery of tax, modes of its recovery, and recovery through State Governments.

25.7 CHECK YOUR PROGRESS: MODEL ANSWERS

1. (a) There are three ways of collecting tax on total income. They are:
 - (i) deduction of tax at source
 - (ii) advance payment of tax and
 - (iii) tax on assessment
- (b) Some assesses resort to tax evasion. In order to avoid this type of malpractices by the assessee the Income-Tax Act has made a provision to deduct the tax at source itself. The following are the cases where tax is deducted at source:

Salaries; interest on securities; dividends; interest received on other than securities; lotteries; cross word puzzles; winning from horse races; payments to contractors; insurance commission; payments on the purchase of units of mutual funds or UTI etc.

2. If any assessee pays more than the tax assessed on regular basis, the Central Government has to pay simple interest at 15% per cent on the excess amount of tax. The interest is calculated from 1st April next following the said financial year to the date of regular assessment.

25.8 MODEL EXAMINATION QUESTIONS

I. Essay Questions

Attempt the following essay questions in about 30 lines each

1. What are the provisions of law regarding deduction of tax at source?
2. Explain the provisions of Income-Tax law relating to 'Advance payment of tax'?
3. Describe briefly the procedure of claiming a refund.
4. What are the modes of recovery of tax?

BRAOU

NOTES FOR FILLING IN THE ACKNOWLEDGEMENT FORM

The acknowledgement form has been designed for easy operational facility. Therefore, the total income declared in the return and the prepaid taxes appear first (items with Sl. Nos. 1 to 7) and thereafter follow the items (Sl. Nos. 9 to 20) requiring the details such as incomes under various heads, brought forward losses and chapter VIA deductions etc. The form may contain certain items not applicable to the assessee filing this return form as it has been thought necessary to have a uniform acknowledgement form for Return Form Nos. 1, 2 and 3.

Please furnish only those information which have been asked for in the specific items of the acknowledgement form exactly in the manner give; please do not attempt to total up the entries such as those against item Nos. 16, 19 or 20 etc.

The figures in the acknowledgement form should be the same as the corresponding figures in the return form. In case of loss the corresponding figures should be preceded by a negative sign (—).

Guidelines in respect of filling certain individual items of the acknowledgement form are given below :

- Item No. 1
The figure here should be the same as the figure of total income shown in F. 7 of Part I of the return.
- Item No. 5
Same as 6 (B) (e) of part II of the return.
- Item No. 9
Same as A.8 of part I of the return
- Item No. 10
Same as B.9 of part I of the return
- Item No. 12
Same as the respective total figures in C.16 of part I of the return.
- Item No. 13
Same as D.5 of part I of the return
- Item No. 14
This item contains the figure of aggregate of loss (other than speculation loss) included under any head which is prohibited from being set off against income under another head. Examples of relevance are sections 74A(3) and 77(2) (a). This item is inserted only to check that no set-off is given for loss that is prohibited from being so set off.
- Item No. 15
Mention only that amount which is entitled to be set off against this year's income and not the total amount of brought forward losses and allowances. (vide Part I E of the return)
- Item No. 16
Please mention the amount of deduction admissible under chapter VIA. (vide F. 5 of Part I of the return).
- Item No. 19
This is applicable to only a few taxpayers falling under the sections mentioned in the acknowledgement form.
- Item No. 20
Please give the rebate/relief in tax finally deductible from the tax (vide Part II 2 of the return)