
UNIT I BASIC CONCEPTS-I

Structure

- 1.0 Objectives
- 1.1 Introduction
- 1.2 Broad Mechanism of Income Tax in India
- 1.3 Concept of Income
 - 1.3.1 Definition of Income
 - 1.3.2 Basic Principles
- 1.4 Definition of Person
- 1.5 Definition of Assessee
- 1.6 Permanent Account Number
- 1.7 Assessment Year
- 1.8 Previous Year
- 1.9 Taxation of Previous Year's Income During the Same Year
- 1.10 Concept of Total Income
- 1.11 Accounting Method
- 1.12 Let Us Sum Up
- 1.13 Key Words
- 1.14 Answers to Check Your Progress
- 1.15 Terminal Questions Exercises

1.0 OBJECTIVES

After studying this unit you should be able to :

- explain the income tax administration in India,
- define specific terms which are relevant for the study of the subject.

1.1 INTRODUCTION

Income tax is one of the direct taxes levied by the Central Government. It is considered direct as it is payable in the Assessment Year, directly by the Individual, Hindu Undivided Family, Firms and Corporate Bodies on the income earned during the **previous year (Accounting/Financial Year)**. Therefore, any student of income tax must know the meaning of the terms income, previous year, assessment year, total income and who are the persons liable to **income tax** in India. In this unit we have traced the history of income tax in India and we have also defined all these **terms** as per the provisions of the Income Tax Act as amended up to date.

1.2 BROAD MECHANISM OF INCOME TAX IN INDIA

The First War of Independence in 1857 **was** a major financial **burden** to the English Government which brought it into great financial difficulties. Thus compelled by financial necessities the British Government enacted the Income Tax Act, 1886. The financial crunch resulting from the First World War brought to focus the inadequacies of the said Act. After extensive investigation, the Act of 1922 **was** enacted and was effective for about four decades.

These intervening years saw India gain independence and the new Indian Government felt that the **Income Tax Act** needed a **thorough** overhaul. The Law Commission submitted a draft **bill** in 1958. A committee appointed under the Chairmanship of **Mahabir Tagi in 1958**, also known as the Direct Taxes Administration Committee, to look into the direct tax structure submitted a **draft**. Finally, the old Indian Income Tax Act, 1922 was completely recast in 1961 and a **new** Income Tax Act came into force with effect from **1.4.1962**.

The **administration** of the Income Tax Act, 1962 is done **by the Central Board of Direct Taxes (CBDT)**, which works under the supervision of **the Ministry of Finance**. The **CBDT** is charged with the duty of framing rules for the administration of **the Income Tax Act**. These rules, known as the Income Tax Rules, 1962, contain various **forms** and miscellaneous details. The process of **framing rules** is a very elaborate one, it **involves** notifying the rule first **for** public deliberation, and then for **adoption**. They

are also placed on the tables of the House for information. These Rules are changed as and when the situation warrants.

The CBDT also issues from time to time, various circulars for the direction of the officials of the Income Tax Department and for Information of tax payers. It is, therefore, necessary for a student of income tax to keep himself upto date with the latest provision. The best way to do this is to regularly read various tax journals and other tax publications.

The Finance Act

You may be aware that the Finance Minister of the Government of India presents an estimate of income and expenditure for the coming financial year to the Parliament generally on the last day of February every year. The document is popularly known as 'budget'. It is an important event of the country as it gives the public an idea of the direction the Government is going to follow in the ensuing year. In order to give legal shape to various tax proposals, a bill is also moved which is known as Finance Bill. It contains various provisions as regards direct and indirect taxes. Once the Finance Act is passed, it becomes a law according to which various taxes are charged. It is the Finance Act that contains the rate structure of income tax which would be applicable in that year.

It is therefore, necessary that any student of income tax should not only study the Income Tax Act but also the Income Tax Rules and the latest Finance Act. All these have to be studied simultaneously.

Scheme of Income Tax—An Overview

Every entity whose income (computed in accordance with the Income Tax Act and the Income Tax Rules etc.) is more than the tax free limit as prescribed by the relevant Finance Act, is required to pay tax. The Finance Act of 1990 raised the exemption limit from Rs. 18,000 to Rs. 22,000.

Recognising the diversity, and the need for standardisation of the sources of income, the Income Tax Act has identified five heads of income. They are salaries, income from house property, profits and gains from business or profession, capital gains and income from other sources. Prior to the Assessment Year 1989-90 "income from interest on securities" was a separate head of income. From the Assessment Year 1989-90 onwards such income is taxable either under the head "Profits and gains of business or profession" or 'Income from other sources' depending on whether the securities are held as stock-in-trade or as an investment. The methods of computation of income under these heads are provided in the Act.

The income tax read along with the Income Tax Rules and the Finance Act provides for all the possible situations that are likely to arise in the administration of income tax law.

The Income Tax Act, 1961 extends to the entire country including the State of Jammu and Kashmir, Pondicherry, Dadra Nagar, Haveli, Goa, Daman and Diu and Sikkim. It comprises of more than 400 sections, numbered from 1 through 298, and twelve Schedules of which five schedules, numbering sixth, eighth, ninth and twelfth have been omitted. All these Sections and Schedules form the core of the unit and will be mentioned in the course.

1.3 CONCEPT OF INCOME

Since income tax is levied on the "income" of an entity, it is important to know what is income and how it is computed. In this section we will deal with the definition of income and some basic principles related to it. The procedure of computing total income will be dealt with in detail in some consequent sections.

1.3.1 Definition of Income

The term "Income" is defined in section 2(24) of the Income Tax Act, 1961. However, since "Income" has a very broad scope, it is not possible to attribute some characteristics to the term and define it exhaustively. Therefore, even the Income Tax Act, 1961, gives an inclusive definition of the term. It specifies what is included in the term "Income".

section 2(24) of the Act defines "Income" to include the following items :

- 1) Profits and Gains — This is one of the major sources of income and will be discussed in detail.
- 2) Dividends — The definition of dividend has been given in Sec. 2(22) which expands the meaning of the term.
- 3) 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, or by a scientific research association or sports association. If the contribution is made with the specific instruction that it shall form a part of corpus of the trust or the institution, it shall not be treated as income.
- 4) The value of perquisite or profit in lieu of salary. These have been defined in Sec. 17 and will be dealt with while discussing income from 'salaries'.
- 5) Any special allowance or benefit, other than perquisite included in (4) above specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.
- 6) Any allowances granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.
- 7) 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 such director or person.
- 8) The value of any benefit or perquisite, whether convertible into money or not which is obtained by a beneficiary or a trustee from a trust will be treated as taxable income in the hands of the beneficiary or the trustee, as the case may be.
- 9) Any compensation or other payment made to the 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.
- 10) 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).
- 11) Capital gains arising from the transfer of a capital asset.
- 12) The profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society computed in accordance with Section 44.
- 13) Any sum chargeable to income tax as profits and gains of business or profession or as recovery of losses, expenses or trading liability in respect of which the assessee had been granted a deduction in a previous year or deemed profits.
- 14) Profit on sale of a licence granted under the Imports (Control) Orders, 1955.
- 15) Any cash assistance received or receivable by any person against exports under any scheme of the Central Government.
- 16) Any duty of customs or excise repaid or repayable to any person against exports against exports.
- 17) Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort and betting of any form or nature whatsoever.
- 18) Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund set up under the Employees' State Insurance Act or any other fund for the welfare of such employees.

It is important to note that the items described under (13) above are supposed to be casual in nature and therefore an amount of Rs. 5,000 thereof is not taxed at all.

1.3.2 Basic Principles

As had been mentioned at the very outset, the Act does not define the concept of income but merely states what amounts are to be included in the term 'Income'. The word income has been given a very wide meaning. Therefore, in the absence of any such guidelines, the Income Tax Department and the tax payers have to depend upon the various judgements of the High Courts and the Supreme Court.

All receipts are not income. Only those receipts have to be treated as income which satisfy the tests laid down by various High Courts and Supreme Court.

- 1) The word 'Income' connotes a periodical monetary receipt coming in from some definite source with some sort of regularity. The source need not be a continuously productive one, **but** must be one whose object is the production of income.
- 2) Income is a periodical yield measurable in terms of **money** or money's worth and arises out of **use** of real or personal property **i.e.** the income may be received in cash or kind. Thus the receipts in kind, **which can** be measured in terms of money shall be taxable as income.
- 3) Periodicity or regularity or at least expected **regularity** are important elements of income. Regularity does not imply that a single receipt is not income.
- 4) Income includes monies that have become due though not received.
- 5) A receipt which is 'income' will continue to be so even if it is exempted from tax.
- 6) Income means **real income**. Fictional or technical income cannot be termed income for the **purpose of** the Income **Tax** Act, **1961**.
- 7) Income must **come** from outside. Pocket money received by a student from his father cannot be termed income.
- 8) Legality or otherwise of income or source of income does not dictate whether a receipt can be termed income. You are required to pay tax on illegally earned income as well. This however, does not grant immunity from prosecution.

1.4 DEFINITION OF PERSON

The term "Person" is defined in Section 2(31) of the **Act**. It is an inclusive definition **implying** list of entities which can be treated as a "person." **The** term person includes the following :

- 1) an individual,
- 2) a Hindu Undivided Family,
- 3) a Company, . . .
- 4) a Firm,
- 5) an Association of Persons or a body of individuals whether incorporated or not,
- 6) a Local Authority, and
- 7) every artificial juridical person **not** falling within any of the categories mentioned above.

It will thus be seen that the word person is defined in very wide terms. A minor would also be included in the definition of persons in some circumstances. All the persons described above are liable to pay income tax under the Income **Tax** Act, **1961**.

1.5 DEFINITION OF ASSESSEE"

The term "assessee" has been defined in Section 2(7) of the Income Tax **Act, 1961**:
"Assessee" means a **person by** whom any tax or any other **sum** is **payable under this** Act. The term **is defined** to include the following:

- 1) **Every** person in respect of whom proceedings **have** been started for the assessment of his income
- 2) Every person who is assessable in respect of income of any other person.
- 3) Every person to whom a refund of tax is due.
- 4) Every person who is deemed to be an **assessee** under this Act.
- 5) Every person who is deemed to be an **assessee** in default **under** any provision of this Act.

An **assessee** in default is a person

- i) who is liable to deduct tax at source but does not do so,
- ii) who deducts the tax but does not pay it to **the** Government,
- iii) who fails to pay **instalments** of **advance** income tax in time.

The Act has given a very **wide** definition of this term. Anyone **who is even remotely** connected with the payment or **refund** of **tax** can **be termed** an assessee;

1.6 PERMANENT ACCOUNT NUMBER

Permanent Account Number-(PAN) is a number which identifies a particular **assessee** to the Income Tax Department. It will not change even **though the assessee** changes his place of residence and consequently the **income** tax office which has **jurisdiction** over his place of business or residence.

Every person who is required to pay tax, either on his own behalf or on behalf of another person, is also required to have a Permanent Account Number. In case the person has not already been allotted a PAN (if **the** income tax return happens to be **his** first return), he is required to **make** an application to the Assessing Officer seeking the number.

Every person carrying on any business and whose sales turnover in any previous year is likely to exceed Rs. 50,000 is also required to apply for a PAN, if he does not have one already.

The Assessing Officer may allot a PAN to any person who in his opinion is liable to pay income tax. **The assessee** is required to quote the **PAN** not only on the return of income but also on all the **correspondence** and documents relating to the Income Tax Department. The Central Board of Direct Taxes has the powers to prescribe the transactions, documents etc. on which the **PAN** has to be mentioned.

Any person who is not allotted PAN and who **has** got a **GIR** number can use GIR number for all the purposes mentioned above.

Check Your Progress A

1) Read the following carefully and tick mark the correct answers

- a) Income tax is
 - i) levied by the State Governments
 - ii) a Direct tax
 - iii) an **Indirect** tax
- b) **Budget** of the country is presented to the Parliament on
 - i) **March 31**
 - ii) Last day of February
 - iii) December 31
- c) Income tax rules are **framed** by
 - i) Central Government
 - ii) Income Tax Department
 - iii) Central **Board** of Direct Taxes
- d) **Casual** income is **exempt**
 - i) up to Rs. 15,000
 - ii) fully
 - iii) up to Rs. 5,000
- e) A **GIR** number
 - i) is used in lieu of PAN
 - ii) is used along with PAN
 - iii) has to be used always

2) Define the term Person.

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3) Who is an 'assessee in default'?

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1.7 ASSESSMENT YEAR

Assessment Year (AY) is defined in Section 2(9) of the Income Tax Act, 1961. It means **the period** of 12 months commencing on the April 1, of each year and ending

on **March 31** next. For example, the current assessment year is 1990-91 which commences on April 1, 1990 and will end on March 31, 1991.

It is **the** financial year in which the assessment takes place. An **assessee** is required to pay **tax** in **the** AY on the income that was earned by him in the previous year (explained later in this unit) according to the rates of tax prescribed by **Annual Finance Act**.

To illustrate, the current assessment year is 1990-91 and an **assessee** is required to pay tax in this AY on **the** income that was earned by him in the previous year **1989-90**.

As a precaution, it should be pointed out here that there are a few exceptions to the general **rule** that income earned in the previous year only is taxed in the assessment year. **These** exceptions are dealt with in sub-section 1.9

1.8 PREVIOUS YEAR

We have seen earlier that income is earned in one year but is taxed in the next. The year in which Income is earned is known as Previous Year (PY) and the year in which it is taxed is termed as Assessment Year.

It is also important to learn that all Government business is transacted on the basis of the financial year which commences on April 1, of the year and ends on March 31, of the following year. This period is also known as the fiscal year. We are also aware of the term 'Calendar Year' which commences on January 1, and ends on December 31 of the same year. Prior to the AY 1989-90 an assessee was free to opt for any period of 12 months as his previous year. He could either adopt the calendar year or Diwali to Diwali or Dussehra to Dussehra or some other year. But a drastic change has been introduced w.e.f. 1.4.89, the concept of uniform accounting year has been introduced. All assesseees will hence forth be required to adopt only the financial year (i.e. April 1, to March 31) as previous year. This will greatly facilitate the assessment procedure. Accordingly the provisions of Section 3 have also been amended. The provisions relating to the previous year enforced from the **A.Y. 1989-90** are as follows:

- 1) Previous year means the financial year immediately preceding the assessment year.
- 2) Previous year in relation to the assessment year commencing on 1.4.89, means the period of 12 months which ends on, any day during the financial year immediately preceding the AY.

Where the assessee has adopted more than one period as the previous year in relation to the assessment year commencing on 1.4.88 for different sources of his income, the previous year in relation to the assessment year 1989-90 shall be reckoned separately for each source of income and the longer or the longest of the periods shall be the previous year for the AY 1989-90. This period is also referred to as the "Transitional Previous year." This switch over to uniform accounting year would result in hardships to some assesseees as their previous year would exceed twelve months. To take care of this the tenth schedule which provides for certain modifications in monetary limits, depreciation allowance or rate of tax in cases where the previous year exceeds twelve months.

In case of a business or profession newly set up, or a source of income newly coming into existence on or after 1.4.87 but before 1.4.88 and when the accounts of such business or profession or source of income have not been made up to March 31, 1988 the previous year in relation to the assessment year 1989-90 shall be the period beginning with the date of setting up of the business or profession and ending on 31.3.1989. Let us explain with the help of an example.

- 1) X has been adopting the calendar year i.e. January 1, to December 31, as his Previous Year for his business income. His previous year for the assessment year 1989-90 under the changed provisions will be the period January 1, 1988 to March 31, 1989. A period of 15 months. The previous year for the Assessment Year 1990-91 will however be the 12 month period from April 1, 1989 to March 31, 1990.
- 2) Y sets up a new business on November 1, 1987 and does not close his book on March 31, 1988. For the Assessment Year 1989-90 his previous year will be the period from November 1, 1987 to March 31, 1989 a period of 17 months.

In both the examples above the previous year **exceeded** 12 months. This elongated previous year during the transitional period would cause hardship to the assessee **and** in some cases deprive them of the **full** benefit of certain deductions and **concessions**. Schedule 10 takes care of **this**. The **monetary** limit of the deductions is increased proportionately. For instance casual income under **Sec. 10(3)** is **exempt** up to Rs. 5,000. In case the Transitional Previous year is of 15 months **duration** the amount will be increased by one-fourth **i.e.** (5,000 plus 5,000/4 = Rs. 6,250) or the amount of **deduction** shall be arrived at by multiplying the amount by a fraction in which the numerator is the number of months in the transitional previous year **and** the denominator is twelve **i.e.** Rs. 6,250 (5,000 × 15/12).

1.9 TAXATION OF PREVIOUS YEAR'S INCOME DURING THE SAME YEAR

As stated earlier the income of the previous year is taxed in the assessment year. But **there** are certain incomes for which the tax is paid in the same year. They are discussed below :

1) **Income on non-resident shipping companies** : The income earned by a non-resident shipping company in India will be taxed in the year in which the income is earned. This has been provided for in Section 172 of the Income Tax Act, 1962. It specifies that before the departure of the ship from any port in India, the master of the ship shall prepare and furnish to the concerned Assessing Officer a **return** of the full amount paid or payable to the owner on account of the carriage of passengers, livestock etc. The Assessing Officer shall immediately assess the income and **determine** the tax payable. Seven and a half per cent of the **income** of the shipping company is deemed to be the income chargeable to tax in the same year.

2) **Income of Persons leaving India** : Section 174 provides that if the Assessing Officer feels that an individual may leave India without the intention of coming back, he may determine the total income of the **person** from the date of **expiry of the immediately** preceding previous year to the date of intended departure. The Assessing Officer will also compute the tax payable and will ask the individual to pay the tax so computed before leaving the country.

3) **Income of Persons trying to alienate their assets** : Section 175 provides for the taxation of income of any person who, it appears to the Assessing Officer, is likely to sell, transfer or dispose of any of his assets with a view to avoiding payment of tax on his income, in the same year in which it is earned. The **Assessing Officer** will determine the income from the date of **expiry** of the immediately preceding previous year to the day when such proceedings commence and will serve a demand notice on the assessee.

4) **Income of discounting business** : Where **any business** or profession is **discontinued** in any year, the income of the period from the date of **expiry** of the immediately preceding previous year to the date of **discontinuance** of such business shall be determined and tax on that income computed. It has been provided that any person discontinuing any business or profession shall inform the Assessing Officer of such discontinuance within 15 days thereof.

1.10 CONCEPT OF TOTAL INCOME

The term 'total income' is quite **important** as it is the total income that is put to tax. The **term** is defined in Section 2(45) which says that "total income" means the total amount of income, profits and gains as referred to in Section 5 and computed in the manner laid down in the Act.

- 1) Compute taxable income under **various** heads of income **i.e.** salaries, house property, profits and gains of business and profession, capital gains and other incomes, by allowing deductions in respect of expenses incurred by the **assessee** in earning those incomes up to the extent permissible **under the** provisions.
- 2) Net result of adding taxable incomes from various heads of income is Gross Total **Income**.
- 3) **Out** of the gross total so **computed** make the **deductions** allowed under Section 80 A to 80 U etc. in respect of various expenses **such** as LIC premium,

contribution to Provident Fund, Medical Expenses etc., and various incomes such as dividends, interests etc.

The net income so remaining after allowing all such deductions is termed as total income which will be relevant for computation of tax liability. It is also called Taxable Income.

1.11 ACCOUNTING METHOD

There are three types of accounting methods which are accepted in the accounting world. Sometimes the assessee maintains the accounts on the basis of cash system, a system wherein, income is supposed to be received only when it is received in cash. Till the amount is received, no cognisance is taken of income even if it has been earned. On the other hand there is a system which is based on accruals and not on cash receipts: Third system is a mix of the first two systems wherein, generally, income is reported on the basis of cash system and expenditure is recorded on the basis of mercantile system or accrual system.

Since the assessee is at liberty to use any method of accounting, there is a need to ensure that the assessee does not change his method of accounting in a manner that is prejudicial to the interests of the Revenue. The Income Tax Act, 1961, therefore, provides in Section 145 that the income chargeable under the head 'Profits and Gains of the Business or Profession' or 'Income from other sources' shall be computed in accordance with the method of accounting employed by the assessee. If, however, the Assessing Officer is of the opinion that notwithstanding the correctness of the Accounts the method employed is such that it does not permit proper computation of income, the computation shall be made upon such basis and in a manner that he may determine.

It has been held that though the Assessing Officer may not accept the method of accounting employed by the assessee, he has no right to impose his own method upon the assessee.

An assessee who intends to change his method of accounting is required to make an application to the Assessing Officer. He must prove that the change is regular and not for a casual period and if it is bonafide the Assessing Officer has no reason to reject this change. It has been held in **Ramswarup Bengalimal v. CIT 25 ITR 17** that the burden of providing that the method of accounting has been changed lies on the Department.

Bansilal Abirchand v. CIT 3 ITC 57 holds that if the Department has been accepting the assessee's method of accounting for a number of years, they cannot arbitrarily seek to take him on a different basis in a particular year.

Check Your Progress B

- 1) Fill in the blanks :
 - a) Assessment year is the financial year in which the takes place.
 - b) Assessment year ends on every year.
 - c) Previous year is the immediately preceding the assessment year.
 - d) Total income is income in respect of which income tax is payable.
 - e) Income of discontinued business is taxed in the year.
- 2) X sets up a new business on October 1, 1987 and does not close his books on March 31, 1988. What will the period of previous year for the assessment year 1989-90.

1.12 LET US SUM UP

Income tax is a direct tax and is administered by the Government of India through the Ministry of Finance and Central Board of Direct Taxes. The student is expected to have first hand knowledge of the Income Tax Act, 1961, Income Tax Rules, 1962,

the latest Finance Act and the landmark decisions of the High Courts and Supreme Court.

The **term income** is not exhaustively defined and the **Act** simply enumerates certain items which are included in the **term** 'income'. Similarly the term 'person' is also inclusively defined.

Assessment year is the current financial year in which income earned in the **immediately** preceding financial year (known as previous year) is put to tax. However, there are certain situations when income earned in a particular financial year is put to tax in the same year and the **I.T.O** does not wait for the next financial year. **Gross total income** is arrived at by adding up taxable income from various heads. Out of gross total income **certain** deductions are allowed to arrive at Total Income which is put to tax.

The **assessee** can adopt either cash or accrual basis of accounting. However once the method is adopted it cannot be **changed** without the satisfaction of the Assessing Officer,

1.13 KEY WORDS

Assessee : **Assessee** means a person by whom any tax or any other sum is payable under the Income Tax Act, 1961.

Assessment Year : It is a period of **twelve** months **commencing** on the April 1, of each year.

Gross Total Income : It is the **income** arrived at after adding up all the taxable incomes from various heads of income.

Permanent Account Number : It is a **number** allotted by the Income Tax Department to every assessee.

Previous Year : It is a period of **twelve months** immediately preceding the assessment year.

Total Income : It is the **income** on which tax is payable.

1.14 ANSWERS TO CHECK YOUR PROGRESS

A 1) a) ii b) ii c) iii d) iii e) i

B 1) a) assessment b) March 31 c) period of 12 months d) **taxable** same
2) 18 months

1.15 TERMINAL QUESTIONS EXERCISES

Questions

- 1) "The income of the previous year is taxed in the current year". Explain.
- 2) Distinguish between :
 - i) Gross total income and total income.
 - ii) Previous year and Assessment year.

Exercises

- 1) Are the following incomes as defined under the Income Tax Act, 1961 :
 - i) Pagdee realised by the landlord from tenants **foreletting** out shops.
 - ii) Prize received in a state lottery.
 - iii) Stakes won in a **horse** race.
 - iv) Tips received by a waiter in a hotel.
 - v) Gift of a sum of Rs. 10,000 by a husband to his wife on her birthday.
 - vi) Amount received on sale of old books.
 - vii) Lump sum payment for supplying technical **know-how**.

- viii) Lumpsum paid for waiver of royalty.
- ix) Lumpsum payment in consideration of cancelling service agreement.
- x) Lumpsum payment on reduction of remuneration.
- xi) Lumpsum payment on **termination** of employment.
- xii) Damages awarded by Court to company for breach of contract.
- xiii) Compensation for **relinquishing** the rights of a partner..
- xiv) Profit from a solitary transaction of purchase and sale of land.
- xv) Unclaimed balance distributed to partners.

(Answers)

- i) No ii) Yes iii) Yes iv) Yes v) No vi) No vii) Yes viii) Yes
ix) Yes x) **Yes** xi) Yes xii) Yes xiii) No xiv) Yes xv) No

Note: These questions and exercises will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 2 BASIC CONCEPTS-II

Structure

- 2.0 Objectives
- 2.1 Introduction
- 2.2 **Agricultural Income**
 - 2.2.1 Definition of Agricultural Income
 - 2.2.2 Kinds of Agricultural Income
 - 2.2.3 instances of Non-agricultural Income
 - 2.2.4 Partly Agricultural Income
 - 2.2.5 Taxation of Agricultural Income
- 2.3 / Concept of Casual Income
 - 2.3.1 Definition of Casual Income
 - 2.3.2 Casual Income or Personal Gift?
 - 2.3.3 Chargeability of Casual Income
 - 2.3.4 A Few Examples
- 2.4 Capital and Revenue Receipts — Importance of Distinction
 - 2.4.1 Distinguishing Tests
 - 2.4.2 Examples of Capital and Revenue Receipts
- 2.5 Let Us Sum Up
- 2.6 Key Words
- 2.7 Answers to Check Your Progress
- 2.8 Terminal Questions Exercises

2.0 OBJECTIVES

After studying this unit, you should be able to :

- explain agricultural income, and taxation thereof,
- explain casual income and tax treatment thereof,
- differentiate between capital and revenue.

2.1 INTRODUCTION

In Unit 1 you have learnt about various terms used in the Indian Income Tax Act. Two terms namely agricultural income and casual income need further elaboration because they are treated as exempted incomes under the Act subject to certain limitations. This unit also explains the capital and revenue incomes and the importance of distinction between them for determining the inclusion of a particular income in the total income of a person.

2.2 AGRICULTURAL INCOME

Agricultural income is not taxed under the Income Tax Act, 1961, because agriculture being a State subject, it is the State Government alone which is competent to tax income therefrom. The exemption to this income is provided under Section 10 (1) of the Act. Since it is not taxed, the definition thereof has assumed significance. The assessee would naturally be interested in classifying his income as agricultural incomes howsoever distantly it might have been related to agriculture. On the other hand, the tax authorities would like to interpret the term conservatively and thus there is a possibility of some dispute between the parties as regards the meaning of the term. The Income Tax Act, 1961, has defined the term 'agricultural income' under Section 2(1A) exhaustively.

2.2.1 Definition of Agricultural Income

Agricultural income as defined under Section 2(1) means any rent or revenue derived from land which is situated in India and is used for agricultural purposes (2(1)(a)). The definition makes it very clear that any rent or revenue (in cash or kind) will be agricultural in nature only if the following conditions are fully satisfied :

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

Since the term 'agriculture' will determine the nature of income, it is necessary for us to be able to understand what is agriculture. Income is said to have been derived from land, from agriculture when that land is subjected to the labour and skill of man whether in the form of cultivation or otherwise. Though tilling is not a necessary part of agriculture, human labour and skill are supposed to be expended on the land itself and not merely on the growth from land.

The Supreme Court has in CIT v. Raja Benoy Kumar Sahas Roy expounded on the terms 'Agriculture' and 'Agricultural Purposes'. The relevant portion of the judgment is given below :

- i) Agriculture in its most primary sense denotes the cultivation of the field and is restricted to the cultivation of the land in the strict sense of the term, meaning thereby tilling of land, sowing of seeds, planting and similar operations on the land. It also includes in its scope all the operations which foster the growth and preservation of the produce along with the operations required to make the produce marketable. The term comprises within its scope all types of produce regardless of its nature.
- ii) In order to decide whether a particular piece of land has been used for agricultural purpose, there has to be some measure of cultivation of land and some expenditure of skill and labour upon it. Consequently, income from the sale of forest trees growing naturally and without any human intervention cannot be treated as agricultural income.

2.2.2 Kinds of Agricultural Income

Agricultural Income is of Five kinds

- i) Any rent or revenue derived from land
- ii) Income derived from Agriculture
- iii) Any income derived from marketing process performed by cultivator or receiver of rent in kind
- iv) Any income derived from the sale of product
- v) Income from farm building.

(ii), (iii) and (iv) can be combined under one heading and explained. Let us now discuss the different kinds of income in detail.

i) Any rent or revenue derived from land

Rent or revenue derived from land situated in India and used for agricultural purposes is agricultural income. Rent is received by one person from another for the grant of right to the other person to use land. It may be in cash or in kind and the recipient of rent may or may not be the owner of the land.

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

ii) Income derived from such land by agriculture or from manufacturing process (2(1A)(b))

The words 'such land' are of significance here. These words limit agricultural income to the land situated in India which is used for agricultural purposes. The income generated by the following activities is considered agricultural income:

- a) agriculture
- b) process ordinarily employed by a cultivator to render the produce marketable
- c) sale by cultivator of the produce without any further processing except the one mentioned in (b) above.

It is thus clear that the cultivator may need to make the produce marketable as the produce as such may not be sold. He is allowed the use of a process which is generally employed by all the cultivators to make the produce marketable. Tobacco leaves are generally dried before being sold, and therefore, the income from the sale of dried tobacco leaves will be agricultural in nature. However, the income from the sale of beedies made out of the same tobacco will not be treated as agricultural income, because marketable produce has been further processed and made more valuable.

iii) Income from agricultural house properly a farm buildings (2 (1A) (c))

Income derived from any building in the following cases will be agricultural income:

- a) the building is owned and occupied by the receiver of rent or revenue of any such land;
- b) the building is on or in the immediate vicinity of the agricultural land in India;
- c) the agriculturist needs it by virtue of his connection with the land and uses it as a dwelling house, store house or as an outhouse;
- d) 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 the officers of the said Government;
- e) if the land is not subject to land revenue, it must be outside the urban area, i.e., area comprising a cantonment board, municipal board, notified area, town area, municipal corporation or any other name by which it is known and which has a population of 10,000 or more;
- f) if it is notified by the Central Government in the Official Gazette, it must not be situated within a distance of 8 kilometre or within the area of such lower limits from the jurisdiction of such municipal board etc. as the Central Government may notify in this regard.

2.2.3 Instances of Non-agricultural Income

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

- 1) Annuity payable to Vendor of agricultural land or to a person giving up his claim to a piece of agricultural land.
- 2) Commission for selling agricultural produce.
- 3) Income from Dairy Farm.
- 4) Forest produce resulting from wild growth.
- 5) Fisheries.
- 6) Ginning of cotton.
- 7) Harvesting of crop on purchased land.
- 8) Letting out of land for stocking timber or crops.
- 9) Dividend paid out of agricultural income.
- 10) Commission earned by the landlord for selling agricultural produce.
- 11) Profit earned on purchase of standing crop.
- 12) Rearing of silk worms.
- 13) Income from quarries.
- 14) Royalty income of mines.
- 15) Income from poultry farming.

2.2.4 Partly Agricultural Income

There are certain instances where it becomes extremely difficult to classify an income as agricultural or non-agricultural. These are cases where the said income satisfies some characteristics of agricultural income and a few characteristics of business income. Such incomes are said to be partly agricultural in nature. Profit of a sugar mill which grows its own sugarcane is cited as one of the examples of partly agricultural income. In this case income earned till harvesting of sugarcane is agricultural in nature whereas income accruing from the manufacture of sugar is taxable income. Similarly income from growing and selling of tea is partly agricultural income. These two cases have been dealt with under rules 7 and 8 of the Income Tax Rules, 1962.

2.2.5 Taxation of Agricultural Income

Until the assessment year 1974-75, the agricultural income of an assessee had been completely left out of the purview of the Income Tax Act, 1961. However, it was felt that the assessee earning both agricultural income and non-agricultural income have higher taxable capacity. It is correct that the Central Government cannot tax agricultural income but they can certainly tax non-agricultural income at a higher rate if the taxable capacity of the assessee warranted that. In the light of this logic a scheme of partial integration of agricultural income was devised to tax non-agricultural income in the hands of those who were earning both types of incomes.

As per the provision of the act the agricultural and non-agricultural income of the individual earning both the incomes will be clubbed together to find out the rate of tax to be applied for calculating the income tax on non-agricultural income. This will

result in a higher income tax as **compared** to what he would have paid had he not clubbed the two types of income. The provisions are that all assesseees other than companies, registered firms and cooperative societies are required to club the agricultural income with other **incomes** for determining the rate of tax. ii) These provisions will apply **only** if the non-agricultural income exceeds **minimum** taxable limit (Rs. 22,000) and agricultural income exceeds Rs. 600.

Check Your Progress A

- 1) Read the following carefully and tick mark the correct answer:
 - i) **Agricultural** income is left out of **the purview** of the Income Tax Act, 1961 **because**
 - a) India is a socialist democracy
 - b) Agriculture is a State subject
 - c) The Government wants to encourage farmers.
 - ii) Which of the following is non-agricultural income
 - a) Dairy
 - b) **Income** from land let out for drying tobacco leaves
 - c) Income from tilling and sowing cotton.
 - iii) In determining the market value of agricultural produce not ordinarily sold in the market, the profit is
 - a) A flat rate of 15% of the total expenses
 - b) An amount to be determined by the agriculturist
 - c) An amount to be determined by the Assessing Officer.
 - iv) The **assessee** who is not required to club its agricultural and non-agricultural income for rate purpose is
 - a) A company
 - b) An individual
 - c) A HUF.
- 2) State whether the following statements are true or false
 - i) The **income** of a company engaged in growing and selling tea is business income.
 - ii) The clubbing **provisions** for rate purposes will apply irrespective of the amount of non-agricultural **income**.
 - iii) The onus of proving that a source of income is agricultural in nature lies on **the** assessee.
 - iv) Expenses on **transportation** of produce from the farm to the factory are agricultural expenses.

2.3 CONCEPT OF CASUAL INCOME

You will remember from earlier unit that one of the important characteristics of the term 'income' is its regularity or at least expected regularity. However, there may be certain **incomes** which are not regular and which do not arise from any source of income. They are **known** as 'casual incomes'.

2.3.1 Definition of Casual Income

The term 'Casual income' has not been defined **anywhere** in the Income Tax Act, 1961. It is for this reason that we have to depend upon the dictionary meaning of the word 'Casual' and also on the decisions of the various courts.

The word 'Casual' has been defined to mean "subject to or produced by chance, accidental, fortuitous, coming at uncertain times, occasional, **unforeseen**." It therefore is something which comes in at uncertain times and something which cannot be relied upon or calculated to produce income or it may be something which is the result of **chance** or the result of a fortuitous circumstance.

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**, are also treated as casual incomes and are not taxable **upto** a maximum of Rs. 5,000.

One test which **has** been laid down in some cases is **whether** the receipt is one which is foreseen, known and anticipated and provided for by agreement. If it is a result thereof, it **cannot** be described as casual even if it is not likely to recur for a

considerable time. Casual receipts are therefore receipts which are purely accidental and a result of windfall. They accrue without stipulation, contract, calculation and design.

Non-recurring nature means that the receipt is **not** bound to recur and the recipient has no right or claim to expect the recurrence. The burden of proof is on the **assessee** if he claims an item of income to belong to this category.

The following are excluded from the scope of casual income as per **sec 10(3)**

- a) Capital Gains
- b) Receipts arising from business, profession or occupation
- c) Receipts by way of addition to the **remuneration** of any employee e.g. bonus.

2.3.2 Casual Income or Personal Gift

Casual income in excess of Rs. 5,000 is taxable whereas gift remains outside the purview of Income Tax Act, 1961. If the gifted amount exceeds Rs. 20,000, it will be taxed under the Gift Tax Act. Gift is a receipt which is of purely personal nature and therefore cannot be included in the term 'casual income.' The following extract from the Circular of the Board is relevant in this regard:

"Receipts which are of a casual and non recurring nature will be liable to income tax only if they can properly be characterised as "income" either in its general connotation or within the extended meaning given to the term by the Income Tax Act. Hence, gifts of a purely personal nature will not be chargeable to income tax except when they can be regarded as an addition to the salary or when they arise from the exercise of a profession or vocation." Circular No. 158 of 27.12.1974.

2.3.3 Chargeability of Casual Income

Until the assessment year 1974-75 all casual incomes were fully exempt from income tax, but it was found that the provision was being misused and tax being avoided by treating receipts as casual income, hence a limit was imposed on the extent of exemption. At present all receipts, which are of a casual nature are exempted upto Rs. 5,000 in the aggregate.

This would mean that all casual incomes are to be added up to begin with. Then allow a deduction of Rs. 5,000. The resultant figure would be included under the head 'Income from other sources' and taxed like any other income.

2.3.4 A Few Examples

The following incomes are of a casual nature

- a) Participation in lucky prize schemes was held not to amount to business receipts and were held to be casual in nature.
- b) An assessee received a sum before he started business as grant-in-aid from the Government.
- c) A golden hand shake given as a gift by a company to its auditors whose appointment was not renewed was held not to be a professional receipt.
- d) The entrance fee charged by a banking company from its new shareholders.
- e) Amounts received from activities which are indulged in as hobbies and not business.

The following incomes are not of a casual nature

- a) Any receipt (whether in the form of a donation) received from the exercise of an occupation (like teaching Vedanta philosophy).
- b) Tips given to taxi drivers.
- c) Gifts received from clients.
- d) Indirect benefits out of professional conduct.

2.4 CAPITAL AND REVENUE RECEIPTS — IMPORTANCE OF DISTINCTION

It is important to be able to distinguish between capital and revenue. The distinction is significant not only from the point of view of accounting but also for tax matters. Ordinarily speaking when we buy something of durable nature we say that we have

incurred capital **expenditure**. For example buying of furniture is capital **expenditure** and it is shown on the assets side of the Balance Sheet. On the other hand, expenditure incurred on repairs is supposed to be of routine type and it is therefore shown on the debit side of the Profit and Loss Account. In the same way when some receipt is effected for unloading of a capital asset, we classify it as capital receipt. For example, an amount of Rs. 2,00,000 received on the sale of a piece of land will be a receipt of capital nature. On the other hand fees received by an advocate for rendering of professional services will be of revenue nature. It might be of interest to note that the Income Tax Act, 1961, has **not** defined the concept of capital and revenue anywhere and therefore we have to depend on the accounting conventions and pronouncements by courts in this area.

Apart from accounting implications, the distinction between capital and revenue receipts is of great significance in tax matters and in determining the tax liability. Revenue receipts are considered to be taxable in general whereas capital receipts are not. However, where the asset sold brings in some surplus (excess of selling price over the cost of an asset), it is termed as capital gain and will be treated under special provisions of the Act. Tax liability therefore cannot be determined accurately if the receipts are not properly classified as above.

2.4.1 Distinguishing Tests

Based on the judicial pronouncements, a few guidelines have been laid down for the purpose of determining the nature of a receipt. Some important guidelines are discussed below:

- 1) A receipt by way of price or **compensation** on the disposal of circulating capital or stock on trade is a revenue receipt whereas a receipt on the disposal of a capital asset is capital in nature. A capital asset is used to manufacture items or generate income e.g., machines.
- 2) Receipt in substitution of a source of income is of capital nature while the amount that substitutes income itself shall be the income chargeable to tax. For example, compensation for the loss of an agency is a **capital** receipt while the amount received for the breach of a business contract is a revenue receipt.
- 3) In the case of an isolated transaction of purchase and sale of property, the motive of the seller is a deciding factor in determining the nature of receipt. Sale proceeds of securities (where they are held as investment) will be capital receipt whereas it will be of revenue nature if the securities are held as stock in trade.
- 4) When a sum is received for the surrender of certain rights under an agreement, it is a capital receipt because a certain capital asset in the **form** of those rights is being given up. If, however, the sum is received in the nature of **compensation** for the loss of future profits, it will be treated as a revenue receipt.

It would also help, if the following are also taken into consideration when trying to distinguish between capital and revenue receipts :

- 1) Nature of receipt at the initial stage : If the receipt at the **initial** stage possesses the characteristics of a trading receipt, **it will** be taxed as such. If however, at the initial stages, it looks like a capital receipt, it cannot be taxed irrespective of the magnitude and the appropriation of the same by the assessee.
- 2) Nomenclature not decisive : Irrespective of what the parties to a contract call the transaction and the **receipt** arising therefrom, the true nature of the receipt has to be ascertained based on the principles laid down and the circumstances of the case.
- 3) Nature of receipt in the **hands of** the receiver : It is important to note that when considering a receipt, its nature in the hands of the receiver is important. This implies that even if an **item** of expenditure is of a capital nature in the hands of the giver, it very well could be an item of revenue receipt in the hands of the receiver. It is therefore, the nature of receipt in the hands of the receiver that is important and not the nature of the expenditure in the hands of the giver.
- 4) Nature under company law not **important** : It has been held by the Supreme Court that there is no inconsistency between a receipt being a capital receipt under the Company Law and being a revenue receipt under the Income Tax Act, 1961.
- 5) **Lack of assessment in** earlier years **immaterial** : The mere fact that the Income Tax Authorities have failed to levy tax on the interest part of the annual receipt does not change the nature of the receipt. It continues to be part capital and part revenue in nature and thereby **chargeable** to tax on the revenue part.

- 6) **Income from consumable assets** : Profits arising from consumable assets would be of a **revenue** nature although capital asset seems to be getting exhausted or consumed.
- 7) **Exchange rate fluctuation** : Excess income arising to the **assessee** as a result of exchange rate fluctuation will be taxed as **revenue** receipt. If, however, the **profit** arises not as a result of the business of the **assessee** but as accrual to the investment, it will be treated as a capital receipt.
- 8) **Perpetual annuity** : The annuity receivable in exchange for a capital asset is taxable income. **However**, if the annuity is described as **instalment** of a capital **sum** received in exchange for the capital asset, it is not taxable.

2.4.2 Examples of Capital and Revenue Receipts

The following are a few examples of capital receipts

- 1) Receipt **to meet** the capital expenditure is a capital receipt.
- 2) Compensation received for the suspension of an export **licence**.
- 3) **Pagdee** received as **consideration** for grant of monthly tenancies.
- 4) Profit due to fluctuations in the **rate** of exchange of foreign currency.
- 5) Profit from the sale of foreign exchange when the purchase of capital goods in foreign country became impossible.
- 6) Entrance fee collected by a company in respect of new shares.
- 7) **Sale** of assets of a firm at the **time** of its conversion to a company to **the** extent the **consideration** is attributable to sale of land.
- 8) Compensation received for relinquishing the rights of a partnership.

The following are a few examples of revenue receipts :

- 1) Receipt of annuity for transfer of a capital asset.
- 2) Compensation received for compulsory acquisition of **land**.
- 3) Damages received in respect of **repairs** not carried out in time.
- 4) Cash assistance received under an export promotion scheme.
- 5) **Lumpsum** amount received for waiver of royalty.
- 6) **Subsidy** received by a cooperative society from Government.
- 7) Surplus left with **the** seller due to a reduction in export duty.
- 8) Damages receive by a company for breach of contract.
- 9) Sale of import **entitlement** received under an export promotion scheme **against** export.

Check Your Progress B

- 1) Distinguish between casual income and gift.

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- 2) Fill in the blanks :

- i) Net **Casual income** is included under the head
- ii) Casual incomes are exempt from tax under section of the **Income Tax Act**.
- iii) The onus to prove a particular income as being of a casual nature is on the
- iv) receipts are to be **added** in computing the business income.
- v) Sum received for the surrender of a right is a receipt.
- vi) Cash assistance received from the Government is a receipt.

- 3) State whether the following are capital or revenue receipt :
- i) Compensation received for compulsory vacation of place of business.
 - ii) Bonus shares received by a dealer of shares.
 - iii) Sales tax collected from purchaser of goods.
 - iv) Dividend
 - v) Compensation received for suspension of export licence.

2.5 LET US SUM UP

Agricultural income being exempt from tax, it is necessary to comprehend the meaning correctly. Section 2(1) of the Income Tax Act defines it as any rent or revenue derived from land which is situated in India and which is being used for agricultural purposes, **Income** from house property situated on or in the immediate vicinity of agricultural land is also treated as agricultural income provided the house is being used by the agriculturist as outhouse, or for storing of agricultural produce, agricultural implements or cattle etc. It is exempted from tax u/s 10(1) of the Income Tax Act because agriculture being a State subject, Central Government cannot impose tax on income derived therefrom. Income from manufacture of sugar will be partly agricultural in nature if the sugar mill grows sugarcane on its own farms. Similarly income from sale of tea will also be partly agricultural in nature where the tea company grows its own tea. Rules 7 and 8 of the Income Tax Rules describe the method of determination of exempted and taxable portions of such incomes.

Casual income is also exempt but to a limited extent. It is tax free up to a maximum of Rs. 5,000. Excess of casual income over Rs. 5,000 is taxable. It is something which comes as windfall and totally unexpected. **Capital gains**, receipts arising from business, profession or occupation and receipts by way of addition to the remuneration of an employee are not casual incomes within the framework of law of income tax.

It is also important to distinguish between capital and revenue incomes. It is the revenue income that is taxable and not the capital receipts. Amount received for the goods sold and services rendered will be revenue in nature whereas the amount received in exchange of capital asset like house property will be capital receipt. On the basis of accounting principles and judicial pronouncements a few principles have emerged which help to distinguish the capital and revenue incomes.

2.6 KEY WORDS

Agricultural Income : It is income derived from agricultural land situated in India and is exempted from income tax.

Capital Income : Income received in exchange of a capital asset is capital income. It is not taxable. However, where the amount received is in excess over the cost of the asset, such excess is known as capital gain and is taxable.

Casual income : Casual income is the receipt which comes as a windfall and is free from repetition. One can never expect it. Betting, winnings from lotteries etc. though included in the term 'income' u/s 2(24), is treated as casual income according to a circular issued by the Government.

Partly agricultural income : Income from tea gardens and from manufacture of sugar is partly agricultural in nature. Taxable portion is ascertained in accordance with Rule No. 7 and 8 of the Income Tax Rules, 1962.

Revenue Income : Income received as a matter of routine by way of sale of goods or services is revenue in nature and taxable.

2.7 ANSWERS TO CHECK YOUR PROGRESS

- A 1) i) b ii) a iii) b iv) a
 2) i) False ii) False iii) True iv) True

- B** 2) i) **Income** from other sources ii) 10(3) iii) **Assessee** iv) Revenue
v) Capital vi) **Assessee**.
- 3) i) Revenue ii) Capital iii) Revenue iv) Revenue v) Capital

2.8 TERMINAL QUESTIONS EXERCISES

- 1) Define agricultural income and give examples.
- 2) Distinguish between agricultural income and partly agricultural income with examples.
- 3) What do you understand by casual income? **How** are they treated under the Income **Tax** Act?
- 4) Distinguish between capital and revenue incomes.

Note: These questions will help you to understand the unit better. Try to **write** answers for them. But do not submit your answers to the University, these are for your practice only.

UNIT 3 RESIDENTIAL STATUS AND TAX LIABILITY

Structure

- 3.0 Objectives
- 3.1 Introduction
- 3.2 Importance of Residential Status
- 3.3 Categories of **Residential** Status
- 3.4 Rules for **Determining** Residential Status
 - 3.4.1 Individual
 - 3.4.2 Non-Company **Plural** Entities
 - 3.4.3 Companies
 - 3.4.4 Every Other **Person**
- 3.5 Scope of Total **Income** on the Basis of Residence
 - 3.5.1 Resident.
 - 3.5.2 Not Ordinarily Resident
 - 3.5.3 Non-Resident
- 3.6 Kinds of Incomes
 - 3.6.1 Income Received in India
 - 3.6.2 Income Deemed to be Received in India
 - 3.6.3 Income Accruing or Arising in India
 - 3.6.4 Income Deemed to Accrue or Arise in India
- 3.7 Incidence of Tax
- 3.8 Let Us Sum Up
- 3.9 Key Words
- 3.10 Answers to Check Your Progress
- 3.11 Self-assessment Questions/Exercises

3.0 OBJECTIVES

After studying this unit, you should be able to :

- identify categories of assessees on the basis of residential status,
- determine the residential status of assessees,
- explain different types of incomes,
- determine tax liability.

3.1 INTRODUCTION

You are aware that Income Tax Act revolves around **assessee** and his income. In the previous units you have been familiarized with concepts such as assessee, previous year, assessment year etc., which are considered to be foundations of income tax. However, to determine tax liability of an **assessee** it is essential to **know** his residential status. In this unit, we intend to explain the method of applying the rules regarding residential status and thereby determining the scope of total income of an assessee.

3.2 IMPORTANCE OF RESIDENTIAL STATUS

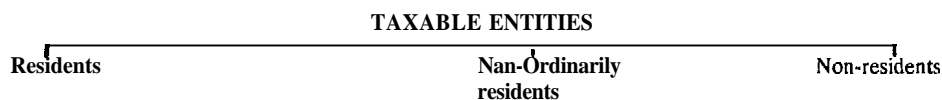
According to Section 4, of the **Income Tax, Act, 1961** tax is to be charged, on the income of the previous year of a person at the rate fixed for the assessment year, immediately following the previous year, by the Annual Finance Act **passed** by Parliament sometime in **April/May** every year. The tax liability of a **person** is **determined** on the basis of his **residence** in India in the previous year. **The** residential status of an **assessee** may not necessarily be the same-in each year, he may be a resident in one year and a non-resident in the next. As such, clear identification of residential status is necessary. It is important to note, however, that the status of an **assessee** will be the same for all sources of income. The rules for determining the residential status are not the **same** for different types of assessees viz., individual, Hindu Undivided Family (HUF), firm and a company etc.

3.3 CATEGORIES OF RESIDENTIAL STATUS

Section 5 of the Income tax Act deals with the scope of total income. It states that the scope of total income of a person is determined by reference to his residence in India in the previous year.

On the basis of residence all taxable entities are divided into three categories, viz.

- a) Persons who are residents in India
- b) Persons who are not ordinarily residents in India
- c) Persons who are non-residents in India



For the purpose of determining the rules applicable in this regard the assesseees are divided into 4 groups, viz.

- i) Individuals,
- ii) Non-company plural entities,
(H.U.F., firms or other association of persons)
- iii) Companies, and
- iv) Every other person.

3.4 RULES FOR DETERMINING THE RESIDENTIAL STATUS

As stated earlier there are separate rules for determining the residential status of different types of assesses. The tests for residence of an individual are contained in Section 6(1), those for Hindu Undivided Families, firms or other association of persons are laid down in Section 6(2), those for companies in Section 6(3) and for every other person in Section 6(4).

3.4.1 Individual

An individual may either be resident, or not **ordinarily** resident, or non-resident, in any previous year depending upon the facts of the case.

A. Resident

The residential status of an individual now depends upon his stay in India, prior to the previous year 1982-83 his dwelling place was also relevant. He will be a resident in India (also referred to as ordinarily resident) if he satisfies anyone of the condition of Part I and both the condition of Part II.

Conditions of Part I (Sec. 6(1))

- a) He is in India in the previous year for a period, or periods amounting in all to 182 days or more,
- b) If he has been in India for a period or periods amounting in all to 365 days or more during the 4 years preceding the previous year and has been in India for 60 days or more during the previous year.

Explanations : In case of an individual

- i) Being a citizen of India if he leaves India in any previous year for the purpose of **employment** outside India, the period of 60 days in clause (b) above will be **extended** to 182 days or more.
- ii) Being a citizen of India or a person of Indian origin, who being outside India, comes on a visit to India in any previous year the **period** of 60 days mentioned in clause (b) will be 90 days or more (From 1.4.1990 these 90 days are extended to 150 days or more). A person is deemed to be of Indian origin if he, or either of his parents or any of his grand parents was born in undivided India.

Conditions of Part II (Sec. 6(6))

- a) If he has been resident in **India** in at least 9 out of the 10 years preceding the previous year, and.

- b) He has been in India for a period or periods amounting in all to 730 days or **more** during 7 previous years preceding **the** previous year.

Stay in India

His stay in India for at least 182 days during the previous year need not **necessarily** be a continuous one and at the same place, **It** is the total duration of his stay in **India** that **will** be considered for the purpose. **It is immaterial** whether he stayed in a **rented** house, or his own house, in a hotel or with some friends, **what** is important is that he must have stayed in India for a period of 182 days or more in the previous year.

Regarding his stay for at least 365 days, the stay may be regular or irregular or **only once** in four years preceding the previous year. But he must have stayed **in** India 365 days in all during the four years. The period of 4 years preceding the previous year means the period of 12 calendar months each immediately preceding the commencement of the relevant previous year.

Again **with** regard to the second condition of Part **I** i.e. his stay for 365 days or more, the stay need not be regular, it could be only once in four years preceding the previous year. It is the total stay which is significant which must be 365 days or **more** in the 4 years preceding the previous year.

Illustration 1

Mr. X an Indian citizen, left for Germany on August 1, 1988 for business. He stayed in Germany **upto** December, 31, 1989. He **came** to India on January 1, 1990 and did not go back. He was never out of India in the past. What will be his residential status for the previous year ending on March 31, 1990?

Solution

For the previous year 1989-90 and the Assessment year 1990-91, Mr. X is a Resident, Mr. X satisfied the second condition of Part **I**, **i.e.**, he has resided in India for 365 days during four years 1985-89 preceding the **previous year** and 60 days during the previous year (1989-90), since he has gone for business purpose. He also satisfies the other two conditions of Part **II**.

- a) He has been resident for nine out of ten years preceding the previous year and
- b) He has also lived in India for 730 days during seven years preceding the previous year.

B. Not Ordinarily Resident

If an individual satisfies any one of the two **conditions** of Part **I**, but does not satisfy both the conditions of **Part II**, he is said to be resident but **not ordinarily resident** or simply stated. He will be a "not ordinarily resident"

Illustration 2

Mr. Mukesh came to India for the first time in July 1988 and stayed in Delhi up to 31st March, 1990. Determine his residential status for the assessment year 1990-91?

Solution

For the assessment year 1990-91, Mr. Mukesh is resident but **not ordinarily** resident.

During the previous year 1989-90 Mr. Mukesh was in India for a period of **more** than 182 days and he there by fulfils the condition (a) of Part **I**. But he does **not** satisfy both the conditions of Part **II**. Therefore, he is resident but not ordinarily resident for the assessment year 1990-91.

C. Non-Resident

If an individual does not satisfy any one of the conditions of Part **I** he is said **to** be non-resident in that previous **year**. Whether he satisfies one **or** both conditions **of** Part **II**.

Illustration 3

Mr. X, a student of Delhi University leaves **India** for **Canada** for higher studies **on** August 15, 1985. During 1989-90 he came to India on July 12, 1989 and stayed **in** Delhi for a **period** of one month and again left for Canada, on August 10, 1989. Determine his residential status for the assessment year **1990-91**?

Solution

Mr. X is a non-resident for the assessment year 1990-91, as he stayed **in** **India** for only 30 days during the previous year 1989-90. As such he does not satisfy any **one** of the basic conditions of Part **I**. Therefore he is a non-resident.

Check Your Progress A

- 1) When is an individual treated as a 'resident' in India?
- 2) When is an individual treated as 'not ordinarily resident in India'?
- 3) Who is a non-resident?
- 4) After 25 years stay in India Mr. Mukesh went to U.S.A. on April 15, 1986 and came back to India on March 12, 1990. Determine his residential status for the assessment year 1990-91?
- 5) Mr. John came to India for the first time on July 10, 1989 and stayed upto February 28, 1990. Determine his residential status for the assessment year 1990-91.
- 6) Mr. Prasad is an Indian citizen who left for Japan on November 15, 1989 on personal work and he did not return during the previous year 1989-90. He was never out of India in the past. Determine his residential status for the assessment year 1990-91?

3.4.2 Non-Company Plural Entities

Under this section we will examine the rules regarding residential status of plural entities such as Hindu Undivided Family (HUF), firms and association of persons.

Hindu Undivided Family (Section 6(2).)

The residential status of an HUF depends on two factors, the location of control and management of its affairs and the residential status of its Karta:

Ordinarily Resident (Section 6(2))

A) HUF is said to be ordinarily resident in India in any previous year :

- a) If the control and management of its affairs is wholly or partly situated in India during the previous year.

The expression 'Control and Management' signifies controlling and directive power. In other words it means the 'head and brain.' Moreover the control and management should be de facto, (in effect) and not merely the right or power to control and manage.

If its manager (Karta) satisfies the following conditions of Section 6(6) :

- i) its manager has been resident in India in 9 out of 10 previous years preceding that year; and
- ii) its manager has, during the 7 years preceding that year, been in India for a period amounting in all to 730 days or more.

For the purposes of calculating the period of the manager's stay in India we shall add up, the stay in India of all the successive managers of the family, in case of the death of the first manager.

Illustration 4

A Hindu Undivided Family carries Import-Export business in India, Nepal, Sri Lanka and Pakistan. The Karta stays in India, and manages the affairs of HUF through employees and agents. What will be the status of the family for income-tax purposes?"

Solution

The control and management of the affairs of the family is situated wholly in India and the manager stays in India and fulfils the conditions of Part II Section 6(6). Hence, the Hindu Undivided Family is resident in India.

B) Not Ordinarily Resident

A Hindu Undivided Family is said to be 'not ordinarily resident in India, if control and management of its affairs is situated wholly or partly in India during the previous year but its manager does not satisfy the conditions of Section 6(6).

C) Non-resident

A Hindu Undivided Family is said to be non-resident in such cases only where its control and management is situated wholly outside India during the previous year. If however the control and management is situated partly in India and the Karta satisfies the conditions of Part II Section 6(6) it becomes a resident in India.

Illustration 5

Head Office of AB a Hindu Undivided Family is situated in Dubai. The family is managed by Mr. A who is a resident in India in only 6 years out of 10 years preceding

the previous year 1989-90). Determine the residential status of the HUF for the assessment year 1990-91 if the affairs of the family business are (i) wholly controlled from Dubai. (ii) partly controlled from India.

Solution

- i) Here the affairs of HUF are controlled and managed from outside India. Therefore AB, a Hindu Undivided Family is **non-resident** for the assessment year 1990-91.
- ii) Under this situation the affairs of HUF are controlled and managed **partly from India**. Therefore the HUF is resident of India. However, it would be resident in India if Karta/Manager satisfies the conditions laid down in Part II Section 6(6) (b) below:
 - i) He has been resident in India, at least 9 out of 10 years preceding the previous year.
 - ii) He has been in India for a period or periods amounting in all to 730 days or more during the seven years preceding the previous year.

As the manager Mr. 'A' is resident in India in only 6 out of 10 years preceding the previous year, the HUF would be 'non-ordinarily resident' in India for the assessment year 1990-91.

Firms and other Association of Persons (Section 6(2))

Firms and other association of persons can fall under two categories only. They may either be residents or non-residents. The category of **non-ordinarily residents** does not apply to such assessee.

A) Resident

A firm or other association of persons is said to be resident in India in any previous year where during that year the control and management of its affairs is partially or wholly situated in India. The residential status of its partners in India is immaterial.

B) Non-Resident

A firm or an association of persons is said to be non-resident in such cases only where the control and management of its affairs is situated wholly outside India during the previous year.

Illustration 6

A firm has five partners who are permanent residents in India. The firm owns a rubber estate in Malaysia. The estate is managed and controlled by the partners in **India**, through an agent in Malaysia. Determine the residential status of the firm.

Solution

Even if the control and management of the firm is partly situated in India the firm becomes resident. Here, all the partners reside in India and manage at least a part of the affairs of the estate. As such the firm is resident in India.

3.4.3 Companies (Section 6(3))

Similar to firm, or other association of persons, companies can also be classified into two categories only. A company may either be a resident or non-resident.

A) Resident

A company is said to be resident in India in any previous year if:

- i) it is an Indian **company**, or
- ii) during the year, the control and management of its affairs is situated wholly in India.

Indian Company : Section 2(26)

Indian company means a company **formed** and registered under the Companies Act, 1956 and includes:

- i) a **company formed** and registered **under** any law relating to **companies formerly** in force in any part of India, other than the state of **Jammu** and **Kashmir** and the union territories,
- ii) a corporation **established** by or **under a central**, or **state** or provincial act.
- iii) any institution, **association** or body which is declared by the **Central Board of Direct Taxes** to be a company under **Section 2(17)**.

- iv) in the case of **Jammu and Kashmir**, a company formed and registered under any law for the time being in force in that state.
- v) in the case of any of the union territories of **Dadra and Nagar Haveli, Daman and Diu and Pondicherry**, a company formed and registered under any law for the time being in force in that union territory.

In all the above cases, it is necessary that the registered or, as the case may be, the **principal** office of the company, corporation institution, association or body is in India.

Control and Management of the Affairs of the Company

A non-Indian company is resident in India if the control and management is wholly situated in India. The term "Control and Management" refers to "head and brain" which directs the affairs of policy framing, finance, disposal of profits and vital things concerning the management of a company.

A company may be resident in India even though its entire trading operations are carried on abroad. If the management and control is situated in India, the company is resident in India. It does not matter where it is registered and where the act of selling and buying of the goods takes place.

B) Non-Resident

If a company does not satisfy any of the aforesaid conditions of residence, it is said to be a 'non-resident' company. In other words if the company is not registered in India and its control and management is situated wholly or partially outside India, it is regarded as a non-resident.

Illustration 7

The Indian **chemicals limited** is a registered Indian company carrying business in India and in Gulf countries. The control and management of its affairs was partially situated in Riyadh (Saudi Arabia) during the year ending March 31, 1990. What will be the residential status of the company for the assessment year 1990-91?

Solution

The Indian chemicals limited is an Indian company, therefore, it should be treated as resident in India and the facts regarding control and management outside the country are immaterial.

Illustration 8

International Remedies is a registered company in Germany, and has a registered office in Germany, but the management and control is situated wholly in **Bombay** (India). What will be the residential status of the company for tax purpose?

Solution

As the company's control and **management** is situated wholly in India it is resident in India, and the location of the registered office of the company is immaterial.

In the above illustration if suppose the control and management is partially situated in **India**, then the company is non-resident in India for tax purpose.

3.4.4 Every other Person (Section 6(4))

A) Resident : Every other person (local authority, artificial, juridical person e.g. : Statutory Corporations) is said to be resident in India in any previous year if **the** control and management of its affairs is partly or wholly situated in **India**.

B) Non-Resident : Every other person is said to be non-resident if control and management of its affairs is situated wholly outside India. .

Note : Every other person is never a 'not ordinarily resident.'

Check Your Progress B

1) State whether each of the following statements is True or False:

- i) A company can never be a 'not ordinarily resident'
- ii) Indian company is a 'resident'
- iii) Hindu Undivided Family cannot be non-resident
- iv) **Firm &** other association of persons can never be 'not ordinarily resident'
- v) On the basis of residence, the persons are divided into 4 categories

- 2) Explain the procedure for determining an individual as resident in India?
- 3) Explain the procedure, for determining a company as resident in India?
- 4) Japan remedies is an International company dealing in pesticides, in India, registered in Tokyo and the control and management of its affairs is wholly situated in Tokyo. Determine the residential status of the company in India?;
- 5) A HUF carries toys business in India. Its control and management is partly situated in India and partly in Canada. The karta (manager) is non-resident in India for the previous year 1989-90. Determine the residential status of HUF in India for the assessment year 1990-91?

3.5 SCOPE OF TOTAL INCOME ON THE BASIS OF RESIDENCE — Section (5)

We have examined the rules determining the residential status of assessee. As stated earlier the scope of total income of an assessee depends on his residential status in the previous year. In the following sections we will explain the scope of total income for the different categories of assessee viz.

- i) residents
- ii) not-ordinarily residents
- iii) non-residents

3.5.1 Resident

The total income of any person, who is resident in the relevant previous year, includes all income from whatever sources derived which

- a) is received, or deemed to be received in India in such year by him or on his behalf; or
- b) accrues or arises or is deemed to accrue or arise to **him** in India during such year; or
- c) accrues or arises to him outside India during such year.

3.5.2 Not Ordinarily Resident

If the **assessee** is 'not-ordinarily resident', the total income of the relevant previous year includes all incomes from whatever sources derived which —

- a) is received or is deemed to be received in India in **such year** by or on behalf of such person; or
- b) accrues or **arises** or is deemed to accrue or arise to him in India during such year; or
- c) accrues or arises to him outside India deriving such 'year and is derived from business controlled in India or a profession set up in India.

Thus it will be seen that the basic difference between the scope of a **total** income of a resident and not ordinarily resident relates to the income which accrues or arises to him outside India. In case of a resident it is included in his total income irrespective of the source of such income. But in case of a not ordinarily resident it will be included in his total only if it is derived from a business which is controlled in or a profession set up in India.

3.5.3 Non-Resident

If the **assessee** is a non-resident in India, the total of the relevant previous year includes all income from whichever sources derived which —

- a) is received or is deemed to be received in India in such year by or on behalf of **such person**, or
- b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Thus non-residents are not liable in respect of **income accruing** or arising outside India even if it is remitted to India.

3.6 KINDS OF INCOME

It appears from the scope of total income that four types of incomes form part of the tax liability. They are :

- 1) Incomes received in India.
- 2) Incomes deemed to be received in India.
- 3) Incomes accruing or arising in India.
- 4) Incomes deemed to accrue or arise in India.

Let us now discuss them in detail.

3.6.1 Income Received in India

Income received in India is taxable in all cases irrespective of residential status of the assessee. The following points are worth noting :

- 1) Income received means the first receipt. It means, the income should be received by the assessee for the first time under his control, in India. For example, salary received by an employee in India is taxable. But salary received by a non-resident individual for the first time outside India and remitted to India afterwards cannot be taxed, because the income cannot be treated as received twice — once outside India and once inside it.
- 2) It is not necessary that income should be received in cash. It may be received in kind also. For example rent-free accommodation and certain other facilities provided to an employee are taxable as 'salary' in the hand of the employee though the income is not received in cash. Though income may be received in kind but for this to be so it is essential that what is received in kind should be the equivalent of cash or should be money's worth e.g. A debtor who gives his creditor a promissory note for the sum he owes can in no sense be said to pay his creditor.
- 3) Tax is attracted by any such income which is received in India whether accrued here or not.

3.6.2 Income Deemed to be Received in India'

The expression 'deemed to be received' only means that although such incomes are not received by the assessee they are treated by law as having been received.

The phrase 'statutory receipt' may conventionally be employed to cover such income. Instance of such statutory receipt are to be found in the provisions of the Act, e.g., Section 7 and Section 198 .

- a) Excessive contribution etc. to the Employee's provident fund. Rule 6 of part A of the Fourth Schedule to the Act provides that, that portion of the annual accretion in any previous year to the balance at the credit of an employee participating in a recognized provident fund, as consists of the following terms, shall be deemed to have been received by the employee in that previous year
 - i) contributions made by the employer in excess of ten per cent of the salary of the employee and
 - ii) interest credited on the balance to the credit of the employee in excess of 12%.
- b) Portion of transferred balance to employee's credit on the date of recognition of Provident Fund Rule 11 of Part A of the fourth schedule provides for treatment of existing balances where recognition is first accorded to an old provident fund. According to this rule the Income Tax Officer shall make a calculation of the aggregate of all sums comprised in a balance transferred to the credit of an employee's account which would have been liable to tax had the fund been recognized on the date of its institution and such aggregate shall be deemed to be the income received by the employee,

Deduction of tax at source **Section 198**, Tax deducted at source according to the provisions of the Act are also deemed to be received by the assessee. Also any dividend paid by the company shall be deemed to be the income of the previous year in which it is declared, distributed or paid. Interim dividend shall also be deemed to be the income of the previous year in which it is unconditionally made available.

3.6.3 Income *Accruing* or *Arising* in India

Income is said to be received when it reaches the **assessee**, but when the **right to receive the income** becomes vested in the assessee, it is said to accrue or arise. **Accrual of income** means a stage where the **assessee** has acquired a right to receive such income, when the same income is actually received in the accounting year it is said to arise. **Income** accrues when the right to receive it comes into **existence** : but it arises when the method of accounting shows it in the shape of profits or gains.

The income must accrue or arise in India. If it accrues or arises outside **India**, it cannot be taxed under the hands of person **who** is non-resident in **India**.

3.6.4 *Income Deemed to Accrue or Arise in India*

Some incomes shall be deemed to accrue or arise in India even if such incomes, in reality, have not accrued or arisen in India. They are as follows

- 1) Income is deemed to accrue or arise in India, if it accrues or arises, **directly or indirectly**:
 - i) Through or from any business connection in India
 - ii) **Through or from** any property in India.
 - iii) Through or **from** any asset or source of income in India, and
 - iv) Through or from any **transfer** of a capital asset situated in India.

Explanation

- a) In case of a business of which all the operations are not carried out in India, **the incomes of the business deemed to accrue or arise in India shall be only that part of the income as is reasonably attributable to the operations carried in India.**
- b) In case of a non-resident no income shall be deemed to **accrue** or arise in India.
 - i) **Through or from operations** which are confined to the purchase of goods in India **for purposes of exports.**
 - ii) If he is engaged **in** the business of running a news agency or a publishing house from operations confined to collection of news or views in India for transmission out of India.
 - iii) Through or from the operations confined to shooting of **any cinematograph film** in India.
- 2) Any salary payable for services rendered in India will be regarded as income earned in India.
- 3) Salary payable by the Government to a citizen of India for the services rendered outside India.
- 4) **Dividend** paid by an Indian company **outside** India.
- 5) Income from interest, royalty or technical fee is deemed to accrue or arise **in India** if :
 - a) It is received by a non-resident.
 - b) It is payable by
 - i) The government
 - ii) **Resident in India who utilises it in India** for business or profession.
 - iii) Non-resident in India who utilises it for business or profession carried on **by him in India.**

Check Your Progress C

- 1) State whether the following are True or False :
 - a) It is not necessary that income should be received in cash.
 - b) The incidence of tax of an **assessee** depends on residential status of the **tax payer**.
 - c) Tax deducted at source is an 'income deemed to be received in India'.
 - d) Dividend paid by an Indian company outside India is not an 'Income deemed to accrue or arise in India.
- 2) **Name** the different kinds of Income
- 3) **Explain** 'Income deemed to **be** received in India.'

3.7 INCIDENCE OF TAX

Incidence of tax is the tax liability of an assessee on different incomes. It depends on his residential status. The following table indicates the tax incidence on income in different situations.

Table 1

Particulars of Income	Tax Liability in case of		
	Resident	Not ordinarily resident	Non-resident
1) Income received in India whether accrued in India or outside India.	Yes	Yes	Yes
2) Income deemed to be received in India whether accrued in India or outside India.	Yes	Yes	Yes
3) Income accruing or arising in India whether received in India or outside India.	Yes	Yes	Yes
4) Income deemed to accrue or arise in India whether received in India or outside India	Yes	Yes	Yes
5) Income received and accrued outside India from a business controlled in India or a profession set up in India.	Yes	Yes	No
6) Income received and accrued outside India from a business controlled from outside India or a profession set up outside India.	Yes	No	No
7) Income earned and received outside India but later on remitted to India.	No	No	No

Table 1 highlights that the tax incidence is the highest in the case of a resident and not ordinarily resident and lowest in the case of non-resident.

3.8 LET US SUM UP

The tax liability of a person is determined on the basis of his residence in India in the previous year. On the basis of residence, the persons are divided into three categories 'namely' (a) Resident (b) Not ordinarily resident (c) Non-resident. Further the categories of persons for tax liability have been classified into four groups 'namely' (a) Individual (b) Non-company plural entities (c) Company (d) Any other person.

The rules for determining the residential status are not the same for all the groups. Different conditions are to be satisfied by the concerned assessee to be a resident in India.

An Individual and a Hindu Undivided Family can be resident, not ordinarily resident and non-resident. A firm and other association of persons, a company and any other person can never be a not ordinarily resident. They can only be either resident or non-resident.

Four types of incomes have been mentioned for the purpose of tax liability.

- a) Incomes received in India.
- b) Incomes deemed to be received in India.
- c) Incomes accruing or arising in India.
- d) Incomes deemed to accrue or arise in India.

The incidence of tax depends on the residential status of an assessee. In case of a resident except income earned and received outside India but later on remitted to India, every other income attracts tax, and the tax incidence is the highest. On the other hand, tax incidence is the lowest in the case of non-resident, as only income which is accrued or received or deemed to accrue or deemed to be received in India, is liable to tax.

Not ordinarily resident in India attracts tax on every income except on 'Income received and accrued outside India from a business controlled from outside India or a profession set up outside India' and on 'Income earned and received outside India but later on remitted to India'. The incidence of tax is relatively higher when compared with 'non-resident'.

3.9 KEY WORDS

Incidence of **Tax** : Tax liability of an assessee.

Indian Company : A company registered in India under the Companies Act, 1956.

Karta : The head of the Hindu Undivided Family, may be Father or eldest son.

Residential Status : Residential status forms the basis for categorisation of **Income tax assessee** as **resident/not ordinarily resident/non-resident**. Different rules have been laid down for determining various types of assessee into the above 3 categories.

3.10 ANSWERS TO CHECK YOUR PROGRESS

- A) 4) Non-resident
5) Not ordinarily resident
6) Resident
- B) 1) i) True ii) True iii) False iv) True v) False
4) Non-resident
5) Non-resident
- C) 1) a) True b) True c) True d) False

3.11 SELF-ASSESSMENT QUESTIONS/EXERCISES

Questions

- 1) Explain the provisions of income tax act for an individual if he is a a) resident b) not ordinarily resident c) non-resident
- 2) What are the different categories into which the assessee are divided on the basis of residence?
- 3) State the conditions which a Hindu Undivided Family has to fulfil in order to be called resident in India.
- 4) Explain the scope of total income under the income-tax 1961.
- 5) What are the criteria for determining the residence of a firm and a company?
- 6) What is the basis of charge of income tax? Give the rules for determining this.

Exercises

- 1) Mr. Subha Rao, a citizen of India is residing at Bombay from 1960. For the first time he left India for Nepal on August 25, 1989, and returned on December 31, 1989. Determine his residential status for the year 1990-91?
(Answer : Resident)
- 2) Mr. Lohit, non-Indian citizen, came to India for the first time on July 13, 1989 and stayed up to January 28, 1990. Determine his residential status for the assessment year 1990-91?
(Answer : Not ordinarily resident)
- 3) Mr. Prakash left India for Kuwait on September 15, 1983 to take up a job in an electronic firm there. He returned to India on March 15, 1990 with an idea to settle in India for ever. What will be his residential status for the previous year 1989-90?
(Answer : Non-resident)
- 4) A Hindu Undivided Family is carrying on a business in manufacturing of coir at Delhi. The Karta is a resident in India for the previous year 1989-90. The control and management of affairs are wholly situated in India. Determine the residential status of HUF for the assessment year 1990-91?
(Answer : Resident)
- 5) Onida shipping company registered in India is dealing in cargo. The control and management of its affairs are situated partly in India and partly in U.K. Determine the residential status of the company in India?
(Answer : Resident)

- 6) ABC is a partnership firm dealing in Unani medicines in India. The control and management of its affairs are wholly situated in Bhutan. Determine the residential status of the firm in India?
(Answer : Non-resident)
- 7) Sri P.C. Reddy an Indian citizen has different sources of income in India and U.K.? He would like to know his tax liability if he is :
- 1) Resident 2) Not ordinarily resident 3) Non-resident in India in respect of the following incomes :
- Incomes from property in U.K.
 - Salary earned and received in India
 - Profits from a business situated in U.K. but controlled from India.
 - Past untaxed foreign income brought to India during the previous year.
 - Dividend paid by an Indian company and received in U.K.
 - Profit earned from a business in Hyderabad.

Answer

	Resident	Not Ordinarily Resident	Non-resident
a	yes	no	no
b	yes	yes	yes
c	yes	yes	no
d	no	no	no
e	yes	yes	yes
f	yes	yes	yes

Note: These questions and exercises will help you to understand the unit better. Try to write answers for them, but do not **submit** your answers to the University. These are for your practice only.

UNIT 4 EXEMPTED INCOMES UNDER SECTION 10

Structure

- 4.0 Objectives
- 4.1 Introduction
- 4.2 Meaning of Exempted Income
- 4.3 List of Exempted Incomes
- 4.4 Certain Exempted Incomes in the Hands of an Individual
- 4.5 Incomes of Charitable and Religious Trusts and Political Parties
 - 4.5.1 Income of Charitable and Religious Trust
 - 4.5.2 Income of Political Parties
- 4.6 Let Us Sum Up
- 4.7 Key Words
- 4.8 Answers to Check Your Progress
- 4.9 Terminal Questions/Exercises

4.0 OBJECTIVES

After studying this unit, you should be able to :

- explain what is exempted income and give reasons for the same,
- classify exempted incomes,
- prepare the list of exempted incomes under Section 10,
- explain various exempted incomes in the hands of an individual,
- explain the provisions regarding incomes of charitable and religious trust and political parties.

4.1 INTRODUCTION

In the earlier lessons you have been familiarised with the important concepts that are commonly used in income tax. You have seen the impact of residential status on the scope of total income of the assessee. The nature of income also has an impact on the total income because certain incomes are exempt under the Income Tax Act. The exemption is granted with various objectives in mind. Some incomes are exempted for social reasons, others to attract foreign investment and foreign exchange earnings, still others are granted to encourage talent, bravery etc. Certain incomes are excluded because their inclusion would amount to taxing the same income twice. In this unit you will study the incomes which are exempted from income tax. You will also learn in detail the exempted incomes of an individual and the provisions regarding the income of charitable and religious trust and political parties.

4.2 MEANING OF EXEMPTED INCOME

Exempted income is that income on which income tax is not chargeable. Such incomes are classified as under :

- i) Incomes which do not form part of total income nor is income tax payable on them. They are called fully exempted incomes.
- ii) Incomes which are included in the total income but are exempt from income tax at the average rate of income tax applicable to the total income. They are called partially exempted incomes.
- iii) Incomes of certain Institutions or authorities are exempted subject to fulfilment of the required conditions.

4.3 LIST OF EXEMPTED INCOMES

As stated in Section 4.2 exempted incomes are divided into three categories. Fully exempted incomes, partially exempted incomes and incomes of certain institutions. It

must, however, be mentioned that in certain cases a limit to the quantum or period is fixed to prevent misuse of the provision e.g. casual income is exempted up to Rs. 5,000 only. Let us now list the incomes under these three categories :

f) Fully Exempted Incomes (Section 10)

The following is the list of incomes exempted under Section 10.

A) Certain Tax-free incomes in the hands of individuals

- 1) Agricultural Income — Sec. 10(1).
- 2) Sums received from HUF — Sec. 10(2).
- 3) Casual and non-recurring incomes — Sec. 10(3).
- 4) Travel concession or assistance — Sec. 10(5).
- 5) Allowances and perquisites for foreign service to citizens of India — Sec. 10(7).
- 6) Salaries in connection with cooperative technical assistance programme — Sec. 10(8)(9).
- 7) Death-cum-retirement gratuity — Sec. 10(10).
- 8) Commuted value of pension — Sec. 10(10A).
- 9) Encashment of earned leave — Sec. 10(10AA).
- 10) Retrenchment compensation to workers — Sec. 10(10B).
- 11) Payment received by an employee of a Public Sector Company for voluntary retirement — Sec. 10(10C).
- 12) Payment from Statutory and Public Provident Fund — Sec. 10(11).
- 13) Payment from Recognised Provident Fund — Sec. 10(12).
- 14) Payment from Approved Superannuation Fund — Sec. 10(13).
- 15) House Rent Allowance — Sec. 10(13A).
- 16) Special Allowance or benefit — Sec. 10(14).
- 17) Receipt of Exchange Risk Premium by Public Financial Institution — Sec. 10(14A).
- 18) Interest on certain Government Securities and Deposits — Sec. 10(15).
- 19) Payment of lease rent — Sec. 10(15A).
- 20) Scholarships — Sec. 10(16).
- 21) Awards — Sec. 10(17A).
- 22) Ex-gratia payments by Central Government — Sec. 10(18A).
- 23) Annual value of Palace of Ruler — Sec. 10(19A).
- 24) Subsidy from Tea Board — Sec. 10(30)
- 25) Subsidy from or through certain boards — Sec. 10(31).

B) Incomes accruing to certain authorities

- 1) Certain incomes of a local authority — Sec. 10(20).
- 2) Income of a Housing authority — Sec. 10(20A).
- 3) Income of approved Scientific Research Association — Sec. 10(21).
- 4) Income of an educational institution — Sec. 10(22).
- 5) Income of medical institution — Sec. 10(22A).
- 6) Income of sports association — Sec. 10(23).
- 7) Income of an association established to encourage certain professions — Sec. 10(23A).
- 8) Income of any Regimental Fund of the Armed Forces — Sec. 10(23AA).
- 9) Income of Khadi and Village Industries — Sec. 10(23B).
- 10) Income of Khadi and Village Industries Board — Sec. 10(23BB).
- 11) Income of statutory bodies for the administration of Public Charitable Trust — Sec. 10(23BBA).
- 12) Income of certain national funds — Sec. 10(23C).
- 13) Income of Mutual Fund — Sec. 10(23D).
- 14) Income of Exchange Risk Administration Fund — Sec. 10(23E).
- 15) Income of a Registered Trade Union — Sec. 10(24).
- 16) Income on behalf of certain funds — Sec. 10(25).
- 17) Income from statutory corporations/bodies for promoting the interests of scheduled castes/tribes — Sec. 10(26B).
- 18) Income of a marketing authority — Sec. 10(29).

C) Incomes in the hands of non-citizens — Sec. 10(6).

- 1) Passage money.
- 2) Remuneration received by an ambassador etc.
- 3) Remuneration received by an employee of a foreign enterprise.
- 4) Remuneration received from foreign philanthropic institutions.
- 5) Income in the hands of a technician.

- 6) Employment on a foreign ship.
 - 7) Employment as a **professor** or other teacher.
 - 8) Employment for research.
 - 9) Remuneration in Training.
- D) Income in the hands of non-residents
- 1) Certain interest received by non-resident Indian Citizens — **Sec. 10(4) and (4B)**.
 - 2) Remuneration received for **rendering** service in connection with shooting of a cinematography film in **India** — **Sec. 10(5A)**.
 - 3) Fee for technical services received by a foreign company — **Sec. (6A)**.
 - 4) Tax paid on behalf of a non-resident — **Sec. 10(6B)**.
 - 5) Income of a foreign company from technical services — **Sec. 10(6C)**.
- E) Miscellaneous incomes
- 1) **Allowances** to members of Parliament and Members of Legislature — **Sec. 10(17)**
 - 2) Income of a Member of a Schedule Tribe — **Sec. 10(26)**.
 - 3) Winnings from lottery by agents — **Sec. 10(26AA)**.
 - 4) Tax-credit certificates — **Sec. 10(28)**.
- F) Income of Newly Established Industrial Undertakings in Free Trade Zones — **Sec. 10(A)**.
- G) Income from Newly Established Hundred Per cent Export Oriented Undertakings — **Sec. 10(B)**.

II) Partially Exempted Incomes — Sec. 86

- 1) Share from unregistered firm.
 - 2) Share from association of persons.
- 11) **Income** of Charitable and Religious Trust and Political Party
- 1) Income of Public Charitable and Religious Trusts — **Sec. 11, 12, 13**.
 - 2) Income of a Political Party — **Sec. 13A**.

Check Your Progress A

- 1) What do you mean by exempted income?
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- 2) Why are certain incomes exempt?
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- 3) What is fully exempted income?
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- 4) What is partially exempted income?
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- 5) List out any ten items of income that are fully exempted?
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4.4 CERTAIN EXEMPTED INCOMES IN THE HANDS OF AN INDIVIDUAL

The list of certain exempted incomes in the hands of an individual is given in Section 4.3. Let us now explain each one of them :

Agricultural Income — Sec. 10(1)

It has already been discussed in Unit 2.

Sums received from Hindu Undivided Family — Sec. 102.

Any sum received by an individual as a member of Hindu Undivided Family is exempt where such sum has been paid to him out of the income of the family. Such receipts will not be taxable in the hands of the member even if the family has not paid any tax on its income. This is however, subject to the provision of Sec. 64(2), which provides that when an individual, who is a member of an Hindu Undivided Family converts his individual property into property belonging to the Hindu Undivided Family, otherwise than for adequate consideration, the income derived from such converted property shall be deemed to be the income of the individual and not the family.

Casual and non-recurring income — Sec. 10(3)

Casual income means "any receipts which are of a casual and non recurring nature. It is unexpected and unforeseen and is not likely to recur". Income from lottery, cross-word puzzles, races, gambling etc. are of casual nature. Awards, gifts received by a sportsman who is not a professional will also be treated as casual income.

However, the following are not treated as casual income.

- i) Capital gains chargeable under Sec. 45
- ii) Receipts arising from business, profession or occupation.
- iii) Receipts by way of addition to the remuneration of an employee.

Casual incomes are exempt upto 5,000 in aggregate. Any excess over Rs. 5,000 is taxable.

Travel concession — Sec. 10(5)

See Unit 6 for clear understanding.

Allowances for foreign service — Sec. 10(7)

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

Salaries in connection with cooperative technical assistance programme — Sec. 10(8) (9)

The remuneration received by an individual who is working in connection with cooperative technical assistance programme under State or Central Government and the Government of a foreign state, is exempt if it is received by him directly or indirectly from the concerned Government. The income of that person and any member of the family of any such Individual accompanying him, which accrues or arises outside India, in respect of which he or that member is required to pay tax to the Government of that foreign state, shall also be exempt.

Death-cum-retirement gratuity — Sec. 10(10), Commuted value of pension — Sec. 10(10A), Encashment of earned leave — Sec. 10(10AA), Retrenchment compensation to workers — Sec. 10(10B), Payment received by an employee of a public sector undertaking for voluntary retirement — Sec. 10(10C) will be discussed in detail in Unit 5 (Salaries).

Payment from Statutory and Public Provident Fund — Sec. 10(11), Payment from Recognised Provident Fund — Sec. 10(12), Payment from approved superannuation Fund — Sec. 10(13) shall be discussed in detail in Unit 7 (Salaries)

House Rent Allowance — Sec. 10(13A), Special Allowance for meeting business expenditure — Sec. 10(14) will be explained in Unit 5 on salaries.

Exchange Risk Premium — Sec. 10(14A)

Any income received by a public financial institution as exchange risk premium from the persons borrowing foreign currency from such institution, provided that the amount of premium is credited in the Exchange Risk Administration Fund.

Interest on **securities** and deposits — **Sec. 10(15)**

See Unit 10 for detailed explanation.

Payment of Lease Rent — **Sec. 10(15A)**

Any payment made by an Indian company engaged in the business of operation of aircraft to acquire an aircraft on lease from the Government of a foreign state or a foreign enterprise under an agreement approved by the Central Government in this behalf.

Scholarships — **Sec. 10(16)**

Scholarships granted to meet the cost of education is exempt.

Awards — **Sec. 10(17A)**

Any payment made whether in cash or kind by the State or Central Government or a body approved by Central Government in pursuance of any award instituted in the public interest is exempted.

Ex-gratia payments — **Sec. 10(18A)**

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

House of a Ruler — **Sec. 10(19A)**

The annual value of any one palace in the occupation of a ruler is exempt.

Subsidy from Tea Board — **Sec. 10(30)**

The amount of any subsidy received by an **assessee** from Tea Board, for growing and manufacturing tea in India is exempted during that assessment year, provided the **assessee** produces a certificate for the amount of subsidy received from the Tea Board.

Subsidy from or through certain Boards — **Sec. 10(31)**

The amount of any subsidy received by an **assessee** engaged in the **business** of growing and manufacturing, rubber, cardamom or other specified commodity in India, from or through the Rubber Board, Coffee Board, Spices Board or any other Board will be exempt **subject** to the producing of a certificate by the **assessee** for the **amount** of subsidy received by him from the Board.

4.5 INCOME OF CHARITABLE AND RELIGIOUS TRUSTS AND POLITICAL PARTIES

Sections 11, 12, 13 and 13A deal with the incomes of charitable and religious trusts and the income of political parties. The income of Charitable and religious trust and political parties are exempt under Income Tax Act. Let us now explain in detail the provisions of **Sec. 11, 12, 13 and 13A.**

4.5.1 Income of Charitable and Religious Trusts

With a view to encouraging public charitable and religious trusts special provisions have been made in the Income Tax Act for granting exemption to the **income** of such trusts, Sections 11, 12 and 13 of the Act deal mainly with the exemption **and** assessment of the income of Public Charitable Trusts.

Charitable **Purposes** — **Sec. 2(15)**

Charitable purposes include the following :

- i) Relief to the poor
- ii) Promotion of Education or literacy
- iii) Hospital or Medical facilities to general public at no cost
- iv) any other activity in the category of charitable purpose.

Religious purposes

Religious purposes means a trust for the advancement, **support**, or propagation of a **particular** religion. But it must be a public religious trust.

Formation of Religious and **Charitable** Trusts

It is not compulsory that the trust should have a deed but it is better if it has an agreement between trustees or **members** of the trust. The trust should work for charitable or religious purposes then only the income of the Public Charitable Trust is entitled for exemption from tax provided the following conditions are satisfied :

- i) The trust should get **itself registered** with the **Commissioner** of income tax within one year from the establishment of the trust.

- ii) if the total income of the trust exceeds Rs. 25,000 in any previous year, the accounts must be audited by a chartered accountant and the report of such audit should be attached with the return of the income.
- iii) The funds of the trust should be invested or deposited in any one or more of the specified modes mentioned in Sec. 11(5) of the Act.

Tax Exemption for Trusts — Sec. 11 and 12

The following incomes of a trust are exempt from tax :

- 1) Income derived from property held under trust or any other legal obligation for charitable or religious purposes.
- 2) Income derived from voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

The above said incomes are exempt from tax, provided the following conditions are satisfied :

- a) The property from which the income is derived must be held under trust or other legal obligation. But, the profit and gains of any business carried on by such trusts, institutions, etc. is not exempt from tax unless :
 - i) The business consists of printing and publishing of religious books and other materials.
 - ii) The business carried on by the trust is wholly for charitable purpose.
 - iii) The books of accounts of such business are maintained separately by the trust or institution.
- b) The income from property held under trust will be exempt from tax only when at least 75% of such income is actually applied to the charitable or religious purposes of the trust in India either during the year in which the income is received or in the next year.
- c) However, in case where at least 75% of the income has not been applied for religious or charitable purposes in India during the prescribed period but is accumulated or set apart either wholly or in part, the amount of income so accumulated will be exempt from tax provided the accumulation is not intended for a period of more than 10 years and the trustees have given written notice to Assessment Officer giving details of accumulation: It is also necessary that the accumulated money has to be deposited in Central/State Government securities, post office, savings-bank account, any bank, Unit Trust of India, Industrial Development Bank of India or immovable property etc. Otherwise the income of trust will be taxable.

Any voluntary contribution received by a trust created wholly for charitable or religious purposes is exempt if the trust fulfils the above three conditions (a, b, c)

4.5.2 Income of Political Parties — Section 13(A)

Political Party means "an association or body of individual citizens of India registered with the Election Commission of India as a political party and includes a political party deemed to be registered with the Commission."

Political parties are liable to pay tax on their income and they are assessed as 'an association of persons'. However, the income derived by these parties as donations and subscriptions is treated as receipt meant for mutual benefits or capital receipts and hence, not liable to tax. Further Sec. 13A exempts the following income of a political party.

- a) Income from House Property
- b) Income from other sources
- c) Voluntary contribution from any person.

However, the income shall be exempt subject to the following conditions :

- i) The party keeps and maintains its books of accounts and other documents properly.
- ii) The accounts of the party are audited by a chartered accountant.
- iii) In respect of each contribution in excess of Rs. 10,000 the party keeps and maintains a record of such contributions and the name and addresses of the persons who have made such contributions.

Check Your Progress-B

- 1) State whether each of the following statements is True or False

- i) Income from voluntary contributions to political parties is not exempt.
 - ii) The income of the individual from his property converted into Hindu Undivided Family property without consideration is treated as the income of Hindu Undivided Family.
 - iii) Casual incomes are of non-recurring-nature.
 - iv) A Hospital established to provide free medical facilities will be treated as a set-up for charitable purposes.
- 2) What are the provisions of **Sec. 10(3)** with regard to casual incomes?

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4.6 LET US SUM UP

Exempted income is that income on which income tax is not chargeable. There are three types of exempted incomes namely

- a) Fully exempted incomes
- b) Partially exempted incomes .
- c) Income of charitable and religious trusts and Political Parties.

Fully exempted incomes are those incomes which are neither included in total income nor income tax is payable on them. The fully exempted incomes are further classified in the following categories :

- i) Income in the hands of an individual
- ii) Income of certain authorities
- iii) Income of non-citizens
- iv) Income of non-residents
- v) Miscellaneous incomes.

Partially exempted incomes are those incomes which are included in the total income but are exempt from income tax at the average rate of income tax applicable to the total income. These are :

- a) Income of a partner in an unregistered firm
- b) Income of a Member of an Association of persons.

Income of charitable and Religious Trusts and Political Parties are also exempt (under Income Tax Act) provided they fulfil the purpose for which they are established.

4.7 KEY WORDS

Casual Income : Casual income means any receipts which are of casual and non-recurring nature.

Fully Exempted Incomes : Incomes which are neither included in total income nor income tax is payable on them.

Non Citizen : Who is not a citizen of India.

Partially Exempted Incomes : Incomes which are included in the total income but are exempt from income tax at the average rate of income tax applicable to the total income.

Political Party : An association or body of individual citizens of India as a political party registered with the Election Commission.

4.8 ANSWERS TO CHECK YOUR PROGRESS

- 1) i) False ii) False iii) True iv) True

4.9 TERMINAL QUESTIONS/EXERCISES

- 1) Explain the following briefly?
 - i) Provisions of Sec. 10(2)
 - ii) Exempted incomes in the hands of non-citizens.
 - iii) Exempted incomes in the hands of non-residents.
- 2) Discuss the provisions of Income Tax Act dealing with the exemption of income of political parties.
- 3) Explain the provisions of Income Tax Act applicable to Charitable or religious trusts?
- 4) Match the following statements :

i) House Rent Allowance	A. Section — 10(3)
ii) Income of Newly Established Industrial Undertakings in Free Trade Zones	B. Section — 10(13A)
iii) Assessment of Income of Political Parties	C. Section — 10(B)
iv) Income from newly Established Hundred per cent Export Oriented Undertaking	D. Section — 13(A)
v) Casual and non-recurring incomes	E. Section — 10(A)

(Answers : i) B ii) E iii) D iv) C v) A

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

SOME USEFUL BOOKS

- Bhagwati Prasad, *Law and Practice of Income Tax*, Navarnan Prakashan, Aligarh' (Chapters 1-3)
- Mahesh Chandra & Goyal S.P., *Income Tax Law and Practice*, 1990, Himalaya Publishing House, Delhi (Chapters 1, 2, 3, 4 & 5)
- Mehrotra, H.C. *Income Tax Law and Accounts 1990*, Sahitya Bhawan, Agra (Chapters 1, 2, 3 & 4)
- Vinod K. Singhania, *Students Guide to Income Tax*, Taxman Publications Private Ltd. (Chapters 1, 2, 3 and 13)

UNIT 5 SALARIES-I

Structure

- 5.0 Objectives
- 5.1 Introduction
- 5.2 Meaning of Salary
 - 5.2.1 Some Important Points Regarding Salary
 - 5.2.2 Definition of Salary for Different Purposes.
- 5.3 Main Items Included in Salary
 - 5.3.1 Salary or Wages
 - 5.3.2 Encashment of Earned Leave on Retirement
 - 5.3.3 Bonus
 - 5.3.4 Pension
 - 5.3.5 Annuity
 - 5.3.6 Gratuity
 - 5.3.7 Advance Salary
 - 5.3.8 Allowances
 - (A) House Rent Allowance
 - (B) Entertainment Allowance
 - (C) Special Allowance Specifically Exempted u/s 10 (14)
 - 5.3.9 Profits in Lieu of Salary
- 5.4 Let Us Sum Up
- 5.5 Key Words
- 5.6 Answers to Check Your Progress
- 5.7 Terminal Questions/ Exercises

5.0 OBJECTIVES

After studying this Unit, you should be **able** to :

- define the term salary
- list the items included under the head salaries
- explain the provisions of Income Tax Act 1961 in relation to the above items.

5.1 INTRODUCTION

A person has to pay tax on the income earned by him in the previous year on the basis of his residential status. 'Income from Salary' is one of the main heads of income. In this unit you will learn the definition of the term salary and **the items** included in the salary income. You will also learn the calculation of the items to be included in salary for tax purposes.

5.2 MEANING OF SALARY

Any remuneration paid by an employer to an employee for the services rendered **by** him is called salary. Salary for income tax purposes not only includes the cash received. It also includes the value of facilities and benefits provided to the employee: The incomes taxable under the head salaries **include**

- 1) any salary due from an employer, or former employer in the **previous** year, whether paid or not
- 2) any salary paid or allowed to **an-employee** in the previous year by or on **behalf** of an **employer** though not due or before it becomes due to him

5.2.1 Some Important Points Regarding Salary

There are some points related to salary which are to be kept in mind. The understanding of these points is very important and it will help you in computing the taxable salary of an individual. They are as follows.

- i) Salaries and Wages: The income tax act makes no distinction between the salaries *i.e.*, remuneration received by executive and wages *i.e.*, remuneration received by workers. Salaries and wages both are to be taken under the head salaries.
 - ii) Relationship of employee and employer: Any payment will fall under the head 'salaries' only when there exists a relationship of employer and employee between the payer and the payee. A person may hold an office and still may not be an employee for example a director of a company.
 - iii) Salaries and Professional Income: A profession involves the making of successive employment. If such employment is incidental to the exercise of profession, the remuneration received thereby will be taxed under Section 28. For example if a Chartered Accountant is appointed to audit the accounts for a particular year, the income from such a contract is professional income and if he is **employed** to look into the accounts of the company regularly the income so received will be salaried income.
 - iv) Payment made after cessation of employment: When the employee leaves the organisation, the employer pays him certain sum like gratuity etc. Any such
- 3) any arrear of salary paid or allowed to him in previous year by or on behalf of an employer or a former employer, if not charged to tax for any earlier previous year.

“ Definition

For the purpose of Sections 15 and 16 of the Income Tax Act the term 'salary' includes:

- i) Wages
- ii) any annuity or pension
- iii) any **gratuity**
- iv) any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages.
- v) any advance of salary
- vi) any payment received by an employee in respect of any period of leave not availed by him *i.e.*, encashment of leave salary.
- vii) the annual accretion to the recognized provident fund of an employee to the extent provided in the rules. This may take two forms. First) employer's contribution to Provident Fund. Second interest credited on the accumulated balance of recognized provident fund standing to the credit of the employee. As per rules employer's contribution to the PF in excess of 10% of the salary of the employee and the interest credited to the PF accumulations in excess of 12% will be considered as salary. It is significant to note that Section 7 deems both the above items as income of the relevant previous year in which the credit has been made.
- viii) Amount of the transferred balance of recognized provident fund to the extent to which it is taxable.

It may be noted that the term 'salary' has been defined in the widest **sense** to include monetary **and non-monetary** items. Certain items like employer's contribution in excess of 10% to PF and interest accrued on PF balance in excess of 12% are treated as salaries and are deemed to be the incomes of the previous year in which the relevant credits are made. This definition of 'salary' is for the purposes of Sections 15 and 16. Section 15 deals with the chargeability of a receipt under the head 'salaries'. Section 16 on the other hand **allows** certain deductions from salaries like standard deduction, entertainment allowance and profession tax.

payment though received after the employee leaves the organisation is taxable under the head salaries as it is received for services rendered in past.

- v) Tax-free salary: Sometimes the employer deducts the tax at source and pays net salary to the employee. In such cases the individual has to show the aggregate salary **i.e.**, net salary plus tax paid in his gross total income.
- vi) Deductions by **employer**: There are **certain** compulsory deductions from **salary** like contribution to provident fund or charges for providing accommodation which are **deducted** by the employer and the **net** salary is given to the employee. **Even** though the amount has been deducted, it is included in the salary **income**. The reason is that it is **only** the application of income.
- vii) **Dearness** Pay: It is a part of basic salary and is assumed to be given under the terms of employment.
- viii) **Due** date of **salary**: The rules are as **follows** :
 - a) for government and semi-government employee the salary is due on first date of next month **i.e.**, salary for February is due on **1st** March. So salary for a previous year **1989-90** will be salary of the month **for March** 1989 to the salary for the month of February 1990.
 - b) for employees of bank and non-government organisations the salary is due on last date of same month **i.e.**, salary for February is due on 28th February so salary income for previous year 1989-90 will be the salary for the month of April 1989 to March 1990.

5.2.2 Definition of Salary for Different Purposes

The definition of 'salary' differs for different purposes. The purposes for which the definition of salary would differ include

- i) Computation of taxable income under the head salaries.
- ii) Calculating the exempted amount of House rent allowance under Section 10 (13A).
- iii) Calculating the value of rent free accommodation or accommodation provided at a **concessional** rent.
- iv) Calculating **qualifying** amount of PF contributions.
- v) Calculating the entertainment allowance.
- vi) Calculating standard deduction under Section 16 (1)
- vii) Calculating exempted gratuity, exempted portion of encashment of earned leave etc.,
- viii) Calculating perquisite value of gas, electricity or water.
- ix) Determination of salary of Rs. **24,000** regarding taxability of perquisites under Section 17(2) iii (c) (specified employees),
- x) Compensation under Section 10 (IOB) Chart 5.1 will help you to know the meaning of 'salary' for different purposes at a **glance**.

Testimonials and personal gifts

Testimonials and personal gifts which are given purely out of **personal affection** and regard, although received by an employee from his employer would not be **chargeable** to tax as salary income. For example suppose an HMT Watch is presented to an employee by a company for completing 25 years of meritorious service, the value of such a watch cannot be taxed as salary in the hands of the employee. Such presents do not occur at regular intervals. They come, probably, once in **the** service career. The immediate nexus of the present is the meritorious service of the employee rather than the contract of employment.

However, it should be noted that whether an item of receipt constitutes personal gifts or testimonial in appreciation of meritorious services depends upon the facts of the particular case. Normally speaking, if there is a general scheme of award applicable to **employees** after they complete a particular span of service, such gifts are

Chart 5.1

Qualifying Amounts of 'SALARY' FOR DIFFERENT PURPOSES

For computation of taxable income under the head salaries	Rent-free House or Concession in rent	House Rent Allowance	Unit of Contribution to R.P.F.	Entertainment Allowance	Standard Deduction u/s 16(1)	Gratuity	Determination of Salary of Rs.24,000 regarding taxability of perquisites under Sec. 17(2)(ixc)	Gas, Electric energy or Water	Compensation u/s 10(10B)
<p>Basic Salary or wages.</p> <p>Advance Salary.</p> <p>Arrears of Salary.</p> <p>Annuity or Pension.</p> <p>Gratuity.</p> <p>Fees, Commission, Bonus.</p> <p>Allowances including Dearness Allowance.</p> <p>Profits in lieu of salary perquisites</p> <p>Excess contribution to R.P.F. by employer over 10% of salary.</p> <p>Excess interest received from R.P.F. over 12% rate of interest will be taxable.</p> <p>Taxable portion of transferred balance to R.P.F.</p>	<p>1 Basic Salary (excluding advance or arrears of salary received)</p> <p>2. Taxable Allowance.</p> <p>3. Bonus.</p> <p>4. Electricity, gas and water bills paid or reimbursed by the employer. provided they are otherwise taxable.</p> <p>5. Commission. (Excluding dearness allowance not entering into retirement benefits of the employee, employer's contribution to R.P.F., allowances exempt from tax, deductible amount of entertainment allowance, and value of perquisites.)</p>	<p>1. Basic Salary.</p> <p>2. Dearness Allowance if the terms of employment so provide. I.e., it is taken into account for retirement benefits, or Dearness Pay. (Excluding all other allowances, bonus or perquisites and all extras).</p> <p>3. Commission based on fixed percentage of turnover achieved by the employee and given under terms of employment.</p>	<p>Same as for House Rent Allowance as per column.</p>	<p>Basic Salary exclusive of any allowance, benefit or other perquisite.</p>	<p>Basic Salary, Fees, Commission, Perquisite, Advance Salary, Arrear of salary, Profit in lieu of salary, Excess contribution by employer to R.P.F. over 10% of salary, Interest credited to R.P.F. in excess of 12% rate, taxable portion of transferred balance to R.P.F. (excluding exempted receipts.)</p>	<p>Same as for House Rent Allowance or Recognised Provident Fund.</p>	<p>Basic Salary, Dearness Allowance, All other allowances. Bonus, Commission, etc. and all monetary payments included in gross salary after allowing deduction u/s 16.</p> <p>For this purpose salary will not include perquisites as they are not received in cash.</p>	<p>Basic Salary exclusive of all extras, but including dearness pay or dearness allowance given under the terms of employment and commission at fixed percentage of turnover achieved by the employee and given under terms of employment.</p>	<p>Salary allowances, value of rent-free or concessional accommodation, light, water or any other amenity and travel concession; but does not include Bonus, Gratuity employer's contribution to any fund for retirement benefits.</p>

treated as personal in nature and exempt from tax. However when there is no such general scheme, and the management awards employees chosen at their own sweet will and pleasure, such payments will constitute salary in the hands of the recipients.

5.3 MAIN ITEMS INCLUDED IN SALARY

Let us have analyse the components of salary income one by one.

5.3.1 Salary or Wages

The term 'salary' may be taken to denote payments made to a higher category of employees like assistants, officers etc. while 'wages' may denote payments made to casual labourers etc. The distinction is not material for Income tax purposes as both the payments are chargeable under the head 'salaries'.

Salary, bonus, commission or remuneration paid to a partner by the firm is merely an appropriation of firm's profits. Just because it is called 'salary' by the firm, it cannot become salary in the hands of the partner. It is taxable in the hands of the partner under the head 'Profits and gains of business or professions' and not under the head 'Salaries'.

Salary in lieu of resignation notice is chargeable on the basis of its receipt. *V.D. Talwar v CIT (1963) 49 ITR 122 (SC)*.

5.3.2 Encashment of Earned Leave on Retirement

An employee can encash his earned leave while in service and also at the time of retirement. Amount received on encashment of earned leave while in service is fully taxable without any exemption. However, where, due to the addition of such leave salary to his normal salary income the employee pays tax at a higher slab rate he will be entitled to relief under Section 89(1).

On retirement

Encashment of unutilised earned leave at the time of retirement is exempted from tax under Section 10 (10 AA) subject to the following provisions:

(i) Government employees

In case of Central/State government employees, any amount received as cash equivalent of leave salary in respect of the period of earned leave to his credit at the time of retirement/superannuation is fully exempt.

The retirement may be on superannuation i.e., retirement on reaching a specified age or otherwise like termination, voluntary retirement etc. Even if the employee voluntarily resigns from service the exemption will apply *CIT V.R.J. Shahney (1966) 159 ITR 160 (Mad)*.

(ii) Other employees

In the case of other employees, leave salary is exempt from tax to the extent of the least of the following:

- (a) The amount of leave encashment actually received.
- (b) Leave salary for which the employee is entitled on the basis of earned leave standing to his credit. This entitlement, to earned leave however cannot exceed 30 days for every year of actual service,

'Salary' for the entitled leave period is to be calculated on the basis of average salary drawn by the employee during the period of ten months, immediately preceding the month in which the employee retired. 'Salary' for this purpose means basic salary and includes dearness allowance if the terms of employment so provide. It also includes commission based on fixed percentage of turnover achieved by an employee as per terms of contract of employment—*Gestetner Duplicators (P) Ltd. v CIT (1979) 177 ITR 1 (SC)*.

- (c) Salary for 8 months of earned leave period. For this purpose 'salary' has the same meaning as explained in (b) above.

(d) Notified monetary ceiling

The CBDT by notification No. S.O. 553 (E) dated 8th June, 1988 has notified the upper monetary limit in respect of exemption of leave salary. In respect of those retiring on or after 1-1-1988, the limit applicable is Rs. 79,920/- employees retiring between July 1, 1987 to December 31, 1987 the limit is Rs. 77,760/-.

It has been clarified that where an employee gets exemption in respect of encashment of earned leave while retiring from the service of one employer and again gets encashment of earned leave from another employer on his retirement from service, the monetary ceiling limit mentioned above will be reduced by the amount of exemption availed of by the employee when retiring from the services of his earlier employer. In other words, the total exemption in respect of leave encashed on retirement from all employers cannot exceed the specified monetary limit.

Where leave salary is paid to the legal heirs of the deceased employee in respect of privilege leave standing to the credit of such employee at the time of his death the same is not taxable as salary. This is because of the fact that there exists no employer-employee relationship in regard to this payment.
(circular letter No. F.35/1) 65-IT (B), dated November 5, 1965.

Cash equivalent of leave salary received by the family of a Government servant who died in harness, is not taxable in the hands of the recipient. (Circular No. 309 dated July 3, 1981.) Illustration 1 will help you to understand the provisions regarding encashment of earned leave during retirement,

Illustration 1

Mr. X is the general manager of Plus Steel Ltd. He draws a salary of Rs. 5000/- per month. He retires on 31st December 1989, after completing 26 years and 11 months of service. He is entitled to one month earned leave for every year of completed service. He has availed of 20 months earned leave while in service. He has encashed the unutilised earned leave while in service. He has encashed the unutilised earned leave standing to his credit on the basis of last drawn salary. He got an increment of Rs. 500/- on 1-7-89. Compute the gross salary of Mr. X for the assessment year 1990-91.

Solution

Mr. X.

Computation of gross salary for assessment year 1990-91.

Salary for 9 months (1-4-89-31-12-89)	
3 X Rs. 4500 + 6 X 5000	= 43,500.00
Encashment of earned leave	
Total earned leave to which X is entitled	27 months
Less earned leave availed	20 months
Balance of credit	7 months
Cash received on the basis of Rs. 5000/- per month.	35,000.00
Less exemption under Section 10 (IOAA) :	
(a) Actual amount received. Rs 35,000/-	
(b) Leave salary for the unutilised entitled period on the basis of average salary drawn during 10 months immediately preceding retirement.	
7 X (5 X 4500 + 5 X 5000)	
10	
4 X Rs. 4750/-	= Rs. 33,250/-
(c) Salary for 8 months of earned leave period	

exempted under the Act.
 $8 \times \text{Rs. } 4750/- = \text{Rs. } 38,000/-$

(d) Rs. 79,920/-		
The least is exempt	Rs. 33,250/-	1,750/-
Excess amount is taxed	(35,000 – 33,250)	
		45,250
Gross Salary		45,250

Note : Section 10 (AA), provides for the basis of average salary drawn during 10 months immediately preceding retirement. It should be read as average salary for 10 months immediately preceding *the months in which retirement took place*. This is a logical reading since the same basis is applicable for calculating exemption in respect of gratuity.

5.3.3 Bonus

This is taxable in the year of receipt. If the employee receives arrears of earlier years' bonus in a subsequent year he is entitled to claim relief under Section 89 (1).

5.3.4 Pension

A person is entitled for pension every month after retirement as per the terms of employment. Pension received both by government and non-government employees is taxable under the head 'Salaries'. Sometimes the employer wants to take lump sum payment in lieu of pension on monthly basis. Such lump sum is known as commuted value of pension the provisions of such commutation are as follows:

Commutation of pension—Section 10 (10 A)

Where an employee gets a lump sum as a **consideration** for commutation of his pension, the sum received constitutes salary in his hands, and is taxable. However Section 10 (10 A) provides for certain exemptions.

- (a) Any commuted pension received by a government employee is fully exempt. Also the entire commuted value of pension received by a government servant who voluntarily resigns and joins the services of a public sector corporation is exempt—circular No. 286 dated 17th November, 1980.
- (b) Non-government employees
 - (i) in a case where the employee receives gratuity, the commuted value of one-third of the whole pension which he is normally entitled to receive and
 - (ii) in any other case, the commuted value of one-half of such pension is exempt.

Any excess over such exempted amount is taxable as salary. Where on account of taxation of commuted pension, the pensioner pays tax on a higher slab rate, he is entitled to relief under Section 89 (i). Arrears of pension are taxable on due basis whether received or not—T.A. *Ramasubramaniam v CIT (1975) 100 ITR 408 (Mad)*.

Look at Illustration 2 for clear understanding of pensions received by different categories of employees.

Illustration 2

Determine the taxable amount of pension for the assessment year 1990-91 in the following cases.

- i) A receives Rs. 1200/- per month as pension from :
 - (a) the Central government
 - (b) a public sector corporation and
 - (c) a private sector company during previous year 1989-90.
- ii) A retires from government service on 30th April 1989. He gets pension of Rs. 1,200/- per month upto December, 1989 with effect from January 1, 1990 he gets one-third of his pension commuted for Rs. 22,000/-.
- iii) A retires from Tata Steel Company Ltd., in June 30, 1989. He gets pension of Rs. 2,000/- per month upto 31-12-1990. With effect from 1-2-1990 he gets 75%

of his **pension** commuted for Rs. 70,000/- at the time of retirement he got Rs. 1,00,000/- as gratuity from the company.

Solution

i) Rs. 14,400/- will be taxable as salary in A's hands for 1990-91 assessment year subject to permissible deductions. It does not matter whether he is a government servant, a servant of public sector, or a private sector company. However, since his total income will be below the taxable limit of Rs. 18,000/- no liability arises for payment of tax.

(ii) Non-commuted pension from
May 89-December 89 Rs. 1200/- X 8 Rs. 9,600/-

Since A is a government servant the entire commuted value of Rs. 22,000/- is exempt from tax.

Uncommuted pension from
1-1-90 to 31-3-90 Rs. 1200/- X 2/3 X 3 Rs. 2,400/-

Total taxable uncommuted pension. Rs. 12,000/-

(iii) Uncommuted pension
from 1-7-89 to 31-1-90 Rs. 2000/- X 7 = Rs. 14,000/-

Commuted value of 75% of pension Rs. 70,000/-

Since A has received gratuity 1/3rd of the commuted value of the whole pension is exempt from tax i.e. Rs. 70,000 X 4/3 X 1/3 = Rs. 31,111/-

Taxable portion of commuted pension Rs. 38,889/-

Uncommuted pension from 1-2-90 to 31-3-90
Rs. 2,000/- X 1/4 X 2 = Rs. 1,000/-

Taxable pension (subject to standard deduction) 53,889/-

5.3.5 Annuity

Annuity means "an yearly allowance, or income, the grant of an annual sum for a term of year, for life or in perpetuity."

(a) Annuity payable by the present employer is taxable as salary.

(b) Annuity received from a past employer is covered by Section 17(3) (ii) under 'any other payment' and hence constitutes profits in lieu of salary and is chargeable to tax as salary.

(c) Annuity from any other person, say from LIC etc., under an insurance policy is taxable as income from other sources.

5.3.6 Gratuity

Gratuity means "a gift or present, often in return for favours or services." Gratuity is paid over and above the normal salary. It is paid in recognition of long and meritorious services, rendered by the employee. The Payment of Gratuity Act, 1972 has legally recognized the concept. Even where the Act is not applicable, invariably all employers provide for payment of gratuity to their employees through the terms of employment.

The tax treatment of gratuity is as follows:

Gratuity paid is taxable as salary. However, Section 10 (10) provides for certain exemptions. Such exempted portion of gratuity is not to be treated as income.

(a) Any death-cum-retirement gratuity received by all categories of central government employees, State government employees or employees of a local authority is fully exempt from income tax.

(b) Any gratuity received by an employee (whose salary does not exceed Rs. 2500/- p.m.) under the Payment of Gratuity Act, 1972 is exempt to the extent specified in that Act.

The following limits are specified by the above Act. The least of these limits is exempt from income tax.

- (a) Actual amount of gratuity received
 (b) Rs. 50,000
 (c) Amount of gratuity to which the employee is entitled.

The entitlement is 15 days salary (7 days for seasonal establishment employees) for every years of completed service. Service for more than six months will be counted as one year. Amount of 15 days salary is to be calculated by dividing the last drawn monthly salary by 26. This is because of a specific decision of the Supreme Court referred to later. In the case of piece-rated employees amount of 15 days wages is to be calculated on the average of total wages (excluding overtime) received for a period of 3 months immediately preceding the termination of the employee.

Salary here includes dearness allowance but does not include any bonus, house rent allowance, overtime wages and any other allowance.

Illustration 3 will help you in computing the taxable amount of gratuity for employees who earn a salary of less than Rs. 2,500/

Illustration 3

B, an employee of TR Co. Ltd. receives Rs. 50,000/- as gratuity as par the provisions of Payment of Gratuity Act 1972. He retires in March 1990 after putting in 26 years and 9 months service. At the time of retirement his monthly salary was Rs. 1700/- Calculate the taxable gratuity in his hands.

Solution

Completed year of service 27 years
 15 days salary i.e. $\frac{1700 \times 15}{26} = \text{Rs. } 980/-$

As per the decision of the Supreme Court in Digvijay Woollen Mills Ltd. v Mahendra Pratap Rai Buch (1980) 4 Taxman 15 (SC) to find out the average day's salary we have to divide the monthly salary by 26.

Limits:

- (i) Gratuity received Rs. 50,000/-
 (ii) 15 days of wages for each completed year of service $\text{Rs. } 980 \times 27$ Rs. 26,460/-
 (iii) Rs. 50,000

The exempted portion of gratuity is Rs. 26,460 and the balance of Rs. 23,540/- (50,000-26,460) will be taxable in the hands of B as salary.

Any other employee:

In case of any other employee other than the two categories mentioned above, the gratuity received by him on his retirement or on his becoming incapacitated prior to retirement or on termination of employment or any gratuity received by his widow, children or dependents on his death is exempt to the extent of least of the following limits:

- (i) Actual gratuity received.
 (ii) Rs. 1,00,000/-
 (iii) **Entitled gratuity:** This is equal to 1/2 month salary for every year of completed service. Average monthly salary is to be calculated on the basis of 10 months' salary immediately preceding the month in which the employee retires.

For calculating completed years of service any fractional portion (even if it amounts to 11 months and 29 days) is to be ignored. This is different from the basis adopted under the Payment of Gratuity Act.

'Salary' for this purpose includes dearness allowance if the terms of employment so provide. It also includes commission if it is payable under the terms of employment at a fixed percentage of turnover achieved by the employee. If however the employee paid commission as a percentage of general turnover of the company which is not

Salaries

related to the turnover achieved by the employee such commission is not to be included in salary.

Any gratuity received in excess of the exempted limit is taxable as salary. However, since the employee will be paying tax on higher slab rates during the year of receipt of gratuity, he will be entitled to claim relief under Section 89(1).

Where gratuity is received by an employee from more than one employer, either in the same year or in different years, the total amount of gratuity exempt cannot exceed Rs. 1,00,000/-

Since gratuity is taxed as salary, existence of relationship of employer and employee is vital. For example the gratuity paid by LIC to its agents does not qualify for any exemption.

Look at Illustration 4 for understanding the calculation of taxable gratuity for employees having salary of more than Rs. 2,500/- p.m.

Illustration 4

A has been working with two companies, X Ltd., and Y Ltd. The following particulars are given to you.

	X Ltd.
Date of retirement	June 1, 1989
Service	30 years, 11 months
Gratuity received	Rs. 1,00,000/-
Basic pay from 1.4.1989	Rs. 4,000/- p.m.
Yearly increment	Rs. 400/-
Increment month	April, 1989
D.A. (considered for retirement benefits)	Rs. 1000/- p.m.
Commission payable to him on sales achieved by him.	2%
Turnover achieved by him in 1988	Rs. 2,40,000/-
Turnover achieved by him in 1989 (up to 31.5.1989)	Rs. 1,20,000/-

	Y Ltd.
Date of retirement	March, 1990
Service	27 years, 10 months
Gratuity received	Rs. 75,000/-
Average salary drawn in 10 months immediately preceding March 90	Rs. 3,600/-

Compute the taxable gratuity in the hands of A for the Assessment year 1990-91.

Solution

	X Ltd.	
Previous year 1989-90—Assessment year 1990-91.		Rs.
Gratuity Received		1,00,000/-
Least of the following is exempted		
(a) Actual gratuity received		1,00,000/-
(b) Average salary		
Basic pay for 10 months immediately preceding the month of retirement		
$2 \times 4000 + 8 \times 3,600$		36,800/-
D.A. $10 \times 1000/-$		10,000/-
Commission		
Turnover for 10 months preceding the month of retirement		
Rs. 1,20,000 + 1,00,000 ($2,40,000 \times 5$)		

= Rs. 2,20,000/-	
2% commission	4,400/-
Salary for 10 months	51,200/-
Salary for one month	5,120/-
No. of completed years of service \times 1/2 Average Salary	76,800/-
(c) Rs. 1,00,000	
Exempted amount	76,800/-
Taxable gratuity is (1,00,000-76,800) i.e.	23,200/-

Y. Ltd.

Previous year 1989-90—Assessment year 1990-91 Limits.

	Rs.
(a) Actual gratuity received	75,000/-
(b) Completed years of service \times 1/2 X Average salary for 10 months immediately preceding the month of retirement $27 \times 1/2 \times 3500 =$ Rs. 47,250/-	
(c) Rs. 1,00,000/- - Rs. 76,800	
being the amount of gratuity exempt already. Rs. 23,200/-	Rs. 23,200/-
Taxable gratuity	
	<u>Rs. 51,800/-</u>
Total taxable gratuity for assessment year 1990-91 is Rs. 23,280 + Rs. 51,800/-	Rs. 75,000/-

5.3.7 Advance Salary

It is common practice for employees to receive salary in advance under conditions of emergency. According to Section 15 tax is chargeable on all salaries (a) which are due whether actually paid or not and also those (b) which are paid whether due or not to the employee during the financial year. In view of this specific provision even advance salary received i.e., salary received for services yet to be rendered would also be taxable in the year of receipt although such salary is not yet due to the employee. Thus salary is taxable at the earliest point of time i.e., on the date of accrual or on becoming due or on receipt of salaries.

Advance against salaries

This is loan availed by an employee which will be repaid by him to his employer in instalments along with interest or free of interest as the case may be. This loan is not to be treated as salary.

For example Mr. X is an employee in T.V.S. Ltd. In March, 1990 he obtained from his company Rs. 10,000/- as a loan to purchase a scooter. He also withdrew from his employer in March, 1990 Rs. 5,000/- being his salary for April, 1990 since the amount of loan was insufficient for the purchase of the scooter.

In computing the income of Mr. X for the assessment year 1990-91 the loan of Rs. 10,000/- is not to be included. However, the salary for April 90 withdrawn by him in March '90 should be included in X's income for the previous year ending 31.3.1990. In other words for the assessment year 1990-91 salary income for 13 months will become taxable in the hands of X.

However once advance salary is taxed in a particular previous year, it will not be taxed again in the succeeding previous year. This is made clear by the explanation to section 15 which specifically provides 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 again in the total income of the person when the salary becomes due.

Relief

It is to be noted that when advance salary is taxed in the year of receipt, more than 12 months' salary may be taxed in one previous year. This will increase the income limit and higher slab rates may be applied in calculating tax payable. In such case of hardship the employee can apply to the Assessing Officer in the prescribed form for relief which will be granted to him by virtue of the provisions of Section 89.

5.3.8 Allowances

Allowance means cash received apart from the salary. All types of allowances like dearness allowance, city compensatory allowance, children's education allowance etc., by whatever name called are taxable as salaries even though they have not been specifically included in the definition.

Now-a-days there is a growing practice by several companies to give such allowances as conveyance allowance, education allowance etc., as voucher payments. In other word the vouchers are so worded that the payments constitute reimbursements towards expenditure actually incurred. The quantum of allowance for each employee over a period of say one year remains constant. Such payments clearly constitute 'salary' in the hands of the recipient.

The allowances may be fully taxable, partially taxable or fully exempted. Chart 5.2 gives the list of these three types of allowances.

Chart 5.2
Allowances

Fully taxable	Partially exempted	Fully exempted
1) Dearness Allowance or Dearness Pay 2) Medical Allowance 3) Tiffin Allowance 4) Servant Allowance 5) Non-Practising Allowance. 6) Hill Allowance 7) Warden Allowance 8) Deputation Allowance 9) Overtime Allowance	1) House Rent Allowance 2) Entertainment Allowance 3) Special Allowances exempt U/S 10(14) (ii) a) Children Education Allowance b) Hostel Allowance c) Composite Hill Compensatory Allowance d) Tribal Area Allowance e) Allowance for meeting personal expenditure to an employee of a transport organisation while on duty during the running of such transport. f) Border Area, Remote Area, Difficult Area or Disturbed Area Allowance.	1) Travelling Allowance 2) Foreign Allowance 3) Allowances to High Court Judges 4) Allowance from UNO 5) Special Allowances notified U/S 10(14)(i) a) Travelling Allowance. b) Daily Allowance c) Conveyance Allowance. for performance of official duty

Let us now discuss Partially Exempted Allowances one by one. Fully taxable and fully exempted **allowances do** not require further elaboration.

A) House Rent Allowance: Section **10(13A)**: Generally employees are paid house rent allowance by their employers to meet the expenditure incurred by them towards house rent. **Under** Section **10(13A)** read with Rule 2A such house rent allowance is exempt from tax subject to the following limits.

- (a) The actual amount of HRA received in respect of the period during which the house was occupied by the employee during the previous year (relevant period) or
- (b) Excess of rent paid by the employee over 10% of salary due to him in respect of the relevant period.

'Salary' for this purpose includes dearness allowance if the terms of employment so provide but excludes all other allowances and perquisites. It includes commission if it is payable under the terms of employment at a fixed percentage of turnover achieved by the employee, or

- (c) (i) 50% of salary due to the employee in respect of the relevant period, where such accommodation is situated at Bombay, Calcutta, Delhi and Madras and
(ii) 40% of salary due to the employee in respect of relevant period, where such accommodation is situated at any other place.

The least of the above three is exempt.

Any excess of HRA received over the exempted amount will be taxed as salary. The exemption in respect of HRA will not be available if the (a) residential accommodation occupied by the assessee is owned by him or (b) the assessee has not actually incurred expenditure on payment of rent in respect of the residential accommodation occupied by him.

Illustration 5 will help you to understand the provisions regarding HRA.

Illustration 5

A is an employee of United Breweries Ltd., in Bangalore. He draws a basic pay of Rs. 5000/- p.m. and D.A. of Rs. 500/- p.m. which is considered for computation of retirement benefits. He earns 5% commission on sales achieved by him. The turnover achieved by him during financial year ended 1989-90 is Rs. 2,00,000/- He is paid HRA of Rs. 2000/- p.m. He pays a rent of Rs. 1,500/- p.m. Calculate his taxable salary for assessment year 1990-91.

Solution

Basic pay	Rs. 5,000/- X 12	60,000/-
D.A.	Rs. 500 X 12	6,000/-
Commission		
	Rs. 2,00,000 X 5/100	10,000/-
HRA received	24,000/-	
Less HRA Exempt u/s 10(13A)		
(i) Actual	Rs. 24,000/-	
(c) Excess of rent paid over 10% of salary.		
	Rs. 18,000/- – 10% of (Rs. 60,000 + Rs. 6000 + Rs. 10,000)	
	= Rs. 18,000 – Rs. 7,600 = Rs. 10,400/-	
(iii) 40% of salary is	Rs. 30,400/-	
The least is exempt	Rs. 10,400/-	
Taxable HRA	(24,000 – 10,400)	<u>13,600/-</u>
Gross Salary		89,600/-
Less standard deduction @ 33% Rs.	12,000/-	<u>12,000/-</u>
Taxable salary		<u>77,600</u>

B) Entertainment Allowance

Entertainment allowance is part and parcel of salary income and it is chargeable to tax. However it is a practical fact that employees to whom such allowance is granted spend a considerable portion thereof on entertaining customers to improve the business prospects of their employer. Realising this situation, the Act has allowed a statutory deduction in respect of entertainment allowance. You will find a detailed discussion of the same in Unit 6 dealing with statutory deductions from salaries.

C) Special Allowances specifically exempted u/s 10(14) (ii) notification No. SO 259(5) dated 27-3-1990 has notified the following allowances in this regard with effect from 1990-91 assessment year.

(a) Composite Hill compensatory allowance or High Altitude allowance or uncongenial climate allowance or snow bound area allowance or Avalanche allowance.

The prescribed limits are Rs. 600/-, Rs. 1200/- or Rs. 150/- per month depending upon the regions.

(c) Border area allowance or remote area allowance or difficult area allowance or disturbed area allowance.

The prescribed limits are Rs. 650/-, Rs. 525/-, Rs. 375/-, Rs. 300/- or Rs. 100/- per month depending on regions.

(c) Tribal allowance

This exemption is available @ Rs. 100/- per month in nine States (i) Madhya Pradesh (ii) Tamil Nadu (iii) Uttar Pradesh (iv) Karnataka (v) Tripura (vi) Assam (vii) West Bengal (viii) Bihar and (ix) Orissa.

(d) Any allowance granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running of such transport from one place to another place is exempt up to a specified limit. The specified limit is 70% of such allowance or Rs. 1000/- p.m., whichever is less.

(e) Children educational allowance—Rs. 50/- per month per child up to a maximum of two children.

(f) Hostel Allowance : Any allowance granted to an employee to meet the hostel expenditure on his child Rs. 150/- p.m. per child up to a maximum of two children.

5.3.9 'Profits' in lieu of Salary

As stated above the term salary includes any profit in lieu of salary, the above term, according to Section 17(3) includes:

(i) Compensation received by an employee on termination of his employment or on modification of his terms **of employment.**

Compensation is basically a capital receipt since it supplants the very source of income i.e., the salary. Capital receipts are not taxable unless by definition they are treated as income. In the present case the termination compensation is specifically treated as profit in lieu of salary. Profits in lieu of salary, as we know are treated as salary by definition. Hence such compensation is taxable as salary.

Some times the terms and conditions of employment may be modified to provide that in future the employer will get lower salaries in lieu of which they will be paid immediately a lump sum consideration. Such payment is taxable as salary.

(ii) Payments from **unrecognised** fund :

Any payment received by an **assessee** from an unrecognized provident fund or other fund (not being an approved superannuation fund) to the extent it consists of employer's contribution and interest thereon is taxable as profits in lieu of salary.

Interest on the **employee's** contribution to an unrecognized provident fund is chargeable to tax as "income from other sources". Employee's **contribution** however is taxed' year to year.

(iii) Any other payments

Any other payments made by an employer or a former employer is included in profits in lieu of salary. Where an employer gives to his employee any sum by way of personal gift and not an appreciation of his services, it is not taxable.

Specific exemptions

The following payments, however, do not constitute profits in lieu of salary.

(i) Exempted gratuity—(Section 10 (10))

(ii) Exempted value of commuted pension—Section 10 (10A)

- (iii) Exempted amount of retrenchment compensation—Section 10 (10B).
- (iv) Compensation received by public sector employee on voluntary retirement—Section 10 (10C)
- (v) Payment from statutory provident fund—Section 10 (11).
- (vi) Exempted amount of accumulated balance (under Rule 8 of Part A of IV Schedule) from recognized provident fund—Section 10 (12).
- (vii) Payment from Approved Superannuation fund—Section 10 (13)

Check Your Progress A

1) What are the rules regarding due date of salary for non-government employees?

.....

2) A is a non-government employee getting a salary of Rs. 2,400. He retires and receives Rs. 45,000 as gratuity. The amount of gratuity to which A is entitled is Rs. 36,000. What is his taxable gratuity?

.....

3) X retires on 30th April 1989. He gets Rs. 2,000 per-month pension up to September 1989. With effect from October 1, 1989 he gets 1/2 of his pension commuted for Rs. 36,000. Calculate the amount of taxable pension for assessment year 1990-91 if he is a government employee.

.....

4) Mr. Mohan who is residing in Delhi gets Rs. 2,500 p.m. as House Rent Allowance. He actually pays Rs. 2,000 p.m. as rent, His salary for the purposes of HRA is Rs. 6,000 p.m. What is the taxable portion of HRA?

.....

- 5) Which of the following is True and which is False
- i) Under Section 10 (10AA) leave salary for a period up to a maximum of eight months is exempt from tax,
 - ii) Family pension received by the wife of a deceased employee is taxable under the 'head Income from other sources'
 - iii) The maximum notified exemption in respect of gratuity received by private sector employees is Rs. 50,000.
 - iv) For calculating the exemption in respect of house rent allowance, all allowances are to be included in 'Salary'.
 - v) Interest on employees contribution to unrecognised provident fund is chargeable under the head salaries.

5.4 LET US SUM UP

Income from salary is one of the main heads of income. Salary means any remuneration paid by the employer to the employee for services rendered. The

meaning of salary for tax purposes is very wide. It not only includes the cash received but also the monetary value of facilities and benefits attached with the office of employment. It includes salary or wages, bonus, pension, annuity, gratuity, leave encashment, advance, fees, contribution to provident fund, profit in lieu of salary.

In order to calculate the taxable salary of an individual the taxable amount of all the above items is to be calculated and added together. The term salary is not only wide it has many meanings. 'Salary' includes different items for different purposes. For example while calculating the encashment of earned leave 'salary' means basic salary, dearness allowance if terms of employment so provide and commission if based on fixed percentage of turnover. For calculating gratuity and HRA 'salary' includes basic salary, DA if terms of employment so provide, Dearness pay and commission if based on fixed percentage of turnover.

5.5 KEY WORDS

Advance against salary: This is loan availed by employee repayable in instalment and is not taxable.

Advance Salary: This is salary received for services yet to be rendered, and is taxable on receipt basis.

Allowance: Monetary benefits attached to an office or employment like conveyance allowance, HRA, etc. for meeting particular requirements connected with the services rendered by the employee or compensation for unusual conditions of service.

Annuity: An yearly allowance, income, the grant of a sum for a term of year, for life or in perpetuity.

Arrears of salary: This means salary due but not yet received.

Commutation of pension: A retired employee who is in receipt of pension can choose to forego a part of his pension in future in lieu of which he can get a lump sum. This is known as commutation. Exemption is available in respect of such commutation subject to limits.

Encashment of earned leave: Usually employees get 30 days of earned leave in a year. This they can accumulate. Generally all organisations allow their employees to encash their earned leave if the accumulation exceeds a prescribed limit. Leave encashed during service period is taxable while leave encashed on retirement is exempt subject to certain limits.

Gratuity: This is a lump sum payment paid to an employee, usually at the time of retirement in recognition of long and meritorious service. Exemption is available subject to certain limits.

Pension: This is a monthly payment received by a retired employee from his former employer. This is taxable as salary income.

Profits in lieu of salary: The Income Tax Act treats certain items like compensation received by an employee on termination of his employment, certain payments from unrecognized provident fund and all other payments made by an employer or former employer as profits in lieu of salary. These are taxable as salary income.

Salary: For income tax purposes this term is much wider than what is commonly understood. It includes not only payments in cash but also monetary value of facilities made available in kind.

5.6 ANSWERS TO CHECK YOUR PROGRESS

- A 2 Rs. 9,000 3 Rs. 16,000 4 Rs. 13,200
5 i) True ii) True iii) False iv) False v) False

5.7 TERMINAL QUESTIONS/EXERCISES

Questions

- 1) What is the meaning of term salary as per Sections 15 and 16 of Income Tax Act 1961 ,
- 2) What are the provisions of Income Tax Act regarding commutation of pension?
- 3) What do you mean by 'profits in lieu of salary'?

Exercises

- 1) Y is employed in **Supercem Ltd.** In March, 1990 he obtained from his company Rs. 12,000 as a loan to purchase a scooter. He also withdrew in the same month Rs. 6,000 being his salary for April, 1990 since the amount of loan was insufficient for the purchase of the scooter. Y drew a consolidated salary of Rs. 5,000 from April 1989 to September 1989 and Rs. 6,000 from October 1989 onwards. Compute Y's gross salary income for 1990-91 assessment year.

(Answer : Rs. 72,000)

- 2) A received the following payments from his employer during the previous year ended 31st March, 1990.

Salary	Rs. 50,000
Advance salary for April, 1990	Rs. 4,500
Loan for purchase of scooter	Rs. 15,000
One HMT watch for completing 25 years of service, valued at	Rs. 1,000

Compute his gross salary for the previous year

(Answer : Rs. 54,500)

- 3) From the following particulars calculate C's gross salary income for the previous year ending 31st March, 1990.

Basic pay	Rs. 4,000 p.m.
D.A.	Rs. 400 p.m.
Earned leave encashed during the year	Rs. 5,000
Earned leave encashed on retirement on 31st March 1990	Rs. 20,000
Completed years of service	20 years
Earned leave to C's credit at the time of his retirement	5 months

(Answer : Rs. 57,800)

- 4) From the following particulars calculate B's gross salary for 1990-91 assessment year.

Basic pay	Rs. 3,000 p.m.
D.A.	Rs. 300 p.m.
Bonus received for 1988-1990 at Rs. 3,000 per year	Rs. 9,000
Earned leave encashed before retirement on 31st March 1990	Rs. 10,000
Earned leave encashed on retirement	Rs. 7,000

(Answer : Rs. 58,600)

- 5) A retires from Tata Steel Company Ltd., on June 30, 1989. He gets pension of Rs. 3,000 per month up to 31.1.1990. With effect from 1.2.1990 he gets 75% of his pension commuted for Rs. 90,000. At the time of retirement he got Rs. 1,00,000 as gratuity from the company. Compute the taxable pension in the hands of A for the previous year 1989-90.

(Answer : Rs. 72,500)

- 6) From the following particulars given by D calculate the exempted amount of gratuity.

Date of retirement	June, 1989
Service	30 years, 11 months
Gratuity received	Rs. 1,00,000
Basic pay from 1.4.1989	Rs. 5,000 p.m.
Yearly increment	Rs. 500
Increment month	May, 1989
D.A. (considered for retirement benefits)	Rs. 1,000 p.m.

Salaries

Commission payable on sales achieved by him	2%
Turnover achieved by him in 1988	Rs. 2,40,000
Turnover achieved by him in 1989 (up to 31st May 1989)	Ks. 1,20,000

(Answer : Rs. 97,350)

- 7) A is an employee of Ispat Ltd. in Madras. He draws a basic pay of Rs. 4,000 p.m. and D.A. of Rs. 400 p.m. which is considered for computation of retirement benefits: He earns 3% commission on sales achieved by him. The turnover achieved by him during financial year ended 1989-90 is Rs. 2,00,000. He is paid HRA of Rs. 1,500 p.m. He pays rent of Rs. 1,500 p.m.

Calculate his gross salary for 1990-91 assessment year..

(Answer : Rs. 64,680)

- 8) From the following particulars furnished by F calculate the gross salary for 1990-91 assessment year.

Basic pay from April, 1989	Rs. 6,000 p.m.
Annual increment due from October each year	Rs. 500
D.A. (not considered for computing retirement benefits)	10% basic pay
Date of retirement	31.3.1990
Completed years of service	20 years
Gratuity received	Rs. 1,00,000
HRA received	Rs. 2,000 p.m.
House rent paid	Rs. 2,000 p.m.
Commission on turnover achieved	Rs. 6,000
Uncashed earned leave at credit on the date of retirement	15 months
Amount received on encashment of the above leave	Rs. 90,000

(Answer : Rs. 1,65,100)

Note : These questions will help you to understand the unit better.. Try to write answers for them; But do not submit your answers to the University. These are for your practice only.

UNIT 6 SALARIES—II

Structure

- 6.0 Objectives
- 6.1 Introduction
- 6.2 Perquisites
 - 6.2.1 Definition of Perquisites
 - 6.2.2 Types of Perquisites
- 6.3 Valuation of Perquisites—All Employees
 - 6.3.1 Rent-free Accommodation—Rule 3(a)
 - 6.3.2 Accommodation at Concessional Rent—Rule 3(b)
- 6.4 Valuation of Perquisites—Specified Employees
 - 6.4.1 Motor-car
 - 6.4.2 Free Lodging and Boarding to Hotel Employees
 - 6.4.3 Free Supply, of Gas, Electricity and Water—Rule 3(d)
 - 6.4.4 Free Education—Rule 3(e)
 - 6.4.5 Conveyance Facility by Transport Undertaking—Rule 3(f)
 - 6.4.6 Free Sweeper, Watchman, Gardener etc.
 - 6.4.7 Medical Benefits
 - 6.4.8 Other Perquisites
- 6.5 Fully Exempted Perquisites
- 6.6 Deduction from 'Salaries'
 - 6.6.1 Standard Deduction—Section 16(i)
 - 6.6.2 Entertainment Allowance—Section 16(ii)
 - 6.6.3 Tax on Employment
- 6.7 Let Us Sum Up
- 6.8 Key Words
- 6.9 Answers to Check Your Progress
- 6.10 Terminal Questions/Exercises

6.0 OBJECTIVES

After going through this unit, you should be able to :

- define the term 'perquisite'
- list different types of perquisites made available to salaried employees
- compute the value of such perquisites
- explain statutory deductions available to a salaried employee.

6.1 INTRODUCTION

In Unit 5 you have learnt about the items to be included under the head 'Salaries'. You also studied about allowances which are nothing but perquisites received in cash. In this Unit you will learn about certain perquisites which are received in kind and can be converted into cash. You will also learn about the valuation of these perquisites and the deductions available from salaries.

6.2 PERQUISITES

Perquisites are payment, fees or profits attached to an office. They are made available to employees in addition to normal salary or wages. Perquisites may be either in cash or in kind, normally however, they are in the form of facilities in kind. The basic concept underlying taxation of perquisites is that it results in a personal advantage to the recipient. For example, if an employee is provided by his employer

with a motor-car which is used exclusively by the former in the discharge of his official duties only, then there is no perquisite involved. When the same is utilised partly for official purposes and partly for personal purposes, then, the value relating to personal use only is taxable. If the same is used exclusively for personal purposes, then, the entire value is taxable as a perquisite. Thus it is clear that reimbursement of travelling expenses to employees for carrying out official duties is not taxable as perquisite in the hands of the employees.

You know that 'perquisite' is a component of salary income. It follows, therefore, that there should exist employer-employee relationship before an item of perquisite can be brought to tax as salary. The value of any perquisite to a person, not arising out of employer-employee relationship is taxable as 'income from other sources'. Thus tips received by waiters from customers are taxable as 'income from other sources'.

It is important that the advantage arising to the employee should have a legal basis. Any unauthorised advantage taken by the employee would not amount to a benefit or advantage [C.I.T. v A.R. Addaikkappa Chettiar (1973) 19 ITR 90 (Mad) and C.I.T. v Kulandaivelu Konar (1975) 100 ITR 629 (Mad).] Suppose A Ltd., allots a bungalow to one of its general managers. Subsequently he resigns from the company. However, he continues to live in the company's bungalow for a year after which he was evicted from the premises through legal proceedings. Now the question arises as to whether any perquisite arises in the hands of the general manager the value of which would be charged as salary in his hands.

It is a fact that he enjoys the possession of the bungalow which does entail some cost to the company and hence there arises a perquisite. In the absence of an employer-employee relationship it is logical to assess the perquisite value as 'income from other sources'. Sometimes, the employees to whom a perquisite is provided, may waive it instead of utilising it. In which case value of the said perquisite cannot be assessed in his hands.

6.2.1 Definition of Perquisites

Interestingly the expression perquisite has also not been defined exhaustively under the Income Tax Act. However, an inclusive definition is given. Accordingly 'perquisite' includes the following:

- i) Rent-free **accommodation** provided to the employee by his employer— Section **17(2) (i)**: The value of this perquisite is to be calculated as prescribed by Rule 3 and is to be included in the taxable salary of all employees— whether their salary is below Rs. 24,000/- or not.
- ii) Accommodation at a concessional rent— Section **17(2)(ii)**: Many a times employers provide accommodation to their employees at concessional rent i.e. where the market rent for the same is much higher than what the employer charges from his employee. The value of concession is treated as a perquisite and is to be included in the taxable salary of all employees irrespective of the fact that their salary exceeds Rs. 24,000 or not.
- iii) The value of any benefit or amenity to specified employees— Section **17(2) (iii)**: Apart from accommodation free of rent or at concessional rent the value of which is to be included in the taxable salary of all the concerned employees without exception, there are many other benefits or amenities **provided** by the employers to their employees either free of cost or at concessional price. Free motor-car, gas, electricity, water, domestic servant, sweeper, gardener, free education etc., are some examples in this regard. The **value** of these perquisites are to be included in the **taxable** salary of employees only under specified conditions. These are:
 - a) By a **company** to an employee who is director thereof:
 - i) **Where** these benefits are provided by a company to its director who is an employee the value of such benefits is to be always included in **the** taxable salary of the director whether his salary is below **Rs. 24,000/-** or not. If the director is not an employee of the company, the value of the benefits should be taxed in his hands as 'income from other sources'. It should be clearly **noted** here that while defining 'income' Section **2(24) (iv)** includes the value of any benefit obtained from a company by a director, whether he is an employee or not.

However, for the purpose of valuing such benefits we cannot apply Rule 3 of the I.T. Rules, 1962 since they are specifically meant for valuation of perquisites provided to employees. It is logical, therefore, to opine that a value which is fair according to the opinion of the Assessing Officer is to be assigned to the perquisite and taxed in the hands of the director as income from other sources.

b) **By a company to an employee who has a substantial interest:** Where the benefits are provided by a company to its employee who has a substantial interest in the company the value thereof is always to be included in his taxable salary whether he is drawing below Rs. 24,000/- or not.

According to Section 2(32) where an employee of the company is the beneficial owner of equity shares carrying not less than 20% of the voting power he is deemed to be an employee who has a substantial interest in the company. Where such person is not an employee of the company, the observations made earlier in connection with a director as to the valuation of such a perquisite and the head under which it is to be charged will equally apply here.

c) **All other employers whose income under head salaries exceeds Rs. 24,000:** All employees, other than directors and employees substantially interested in a company, whose monetary income under the head 'Salaries' exceeds Rs. 24,000/- will be taxed in respect of the value of any benefit or amenity granted free or at a concessional rate by their employers. If the monetary income does not exceed Rs. 24,000/- the value of such benefits is not taxable in their hands.

Calculation of Monetary income for determining specified employee: First of all add all taxable monetary payments like salary, D.A., bonus, commission, fee, advance salary, salary arrears, pension, unexempted house rent allowance, taxable gratuity, profits in lieu of salary, annual accretion to the credit balance of the employee under recognized provident fund, taxable transferred balance of recognised provident fund, all taxable allowances etc..

From the above amount we have to deduct the permissible deductions like standard deduction, entertainment allowance and profession tax. A question arises here whether income under the head 'Salaries' as specified in Section 17(2)(iii) is income before or after allowing the above three deductions. The logical view seems to be that we have to give full effect to all the sections under a particular head of income before we can arrive at the income from that head. Hence the deduction permissible under Section 16 have to be excluded. Where an employee is serving with more than one employer, monetary payments made by all employers should be added up. Thereafter, the deductions under Section 16 should be allowed. If the balance exceeds Rs. 24,000/- the employee is to be treated as a specified employee.

iv) **Obligation of the employee paid or reimbursed by the employer—Section 17(2)(iv):** Where the employer pays or reimburses any amount to an employee towards an obligation which, if the employer had not made the payment, the employee would himself discharge will constitute a perquisite chargeable to tax in the case of all employees whether drawing a salary of Rs. 24,000/- or less.

Here we have to carefully distinguish between two things.

- a) An obligation which the employee himself will certainly discharge even if the employer does not pay or reimburse.
- b) A benefit which the employee himself does not want but keeps on the insistence of the employer.

Examples of the first variety would include: Payment or reimbursement of educational expenses, electricity bills, debts of the employee, income tax dues of the employee etc. However where an employee becomes a member of a club to further the business prospects of his employer then reimbursement of such club bills cannot be taxed under this clause because the employee by himself would not have incurred the expenditure. Even if he derives any personal advantage from such membership the value thereof will be taxable as a perquisite under clause 17(2)(iii) and not under 17(2)(iv). The same principle applies where the employee, on the instructions of his employer, keeps a gardener, pays him wages and gets reimbursement of such wages.

v) **Any, sum payable by the employer to effect an assurance on the life of the assessee or to effect a contract for an annuity:** Section 17(2)(v).

An employer can choose to effect an assurance on the **life** of the employee. Alternatively he can effect a contract of annuity with the LIC or an outside agency to enable his employee to get a regular sum after retirement. The payments towards the premium or the annuity contract **can** either be made directly or through a fund specifically created for this purpose. Under both the cases the payments are to be taxed as perquisites in the hands of the employee. However if the above payments are made through the following funds, they are not to, be treated as perquisites.

- a) A recognized provident fund.
- b) An approved superannuation fund.
- c) A Deposit **L**inked Insurance Fund established under Section 3G of the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 or the Employees Provident Funds and **M**iscellaneous Provisions Act, 1952.

Payments of life insurance premium by the employer under group insurance scheme and **employees'** state insurance scheme is not a taxable perquisite because the employee has only an expectancy of benefit. This is due to the fact that payments thereof **will** be made to the employee's having on his death. Premium paid by an employer towards personal accident policy of an employee is also not a taxable perquisite C.I.T. v Lal'a Shri Dhar (1972) 84 ITR 192 (Delhi).

6.2.2 Types of Perquisites

From the point of view of taxability, perquisites may be classified as:

- A Perquisites taxable for all categories of employees
- B Perquisites taxable for specified employees
- C Tax-free **Perquisites**.

Let us now list the items included in the above three categories of perquisites:

A) Perquisites Taxable for all Categories of Employees :

- i) Rent-free house provided by the employer.
- ii) House provided at concessional rent.
- iii) Any payment made or obligation discharged by the employer in respect of such obligation of the employee which, but for such payment would have been made by the employee himself **e.g.**, payment of club or hotel bills, salary of domestic servant, educational expenses of children of the employee, loan, income tax, etc.
- iv) Any sum paid or payable by the employer in respect of insurance premia on the life of the employee, When an **assessee** (employee of foreign company) is deputed to supervise erection work in India, and is provided **with** rent-free accommodation, provision of which is necessary for discharge of his official duty, it will not be treated as a perquisite. [C.I.T. v D.S. Blackwood (1985) 178 ITR 470].

B) Perquisites Taxable for Specified Employees

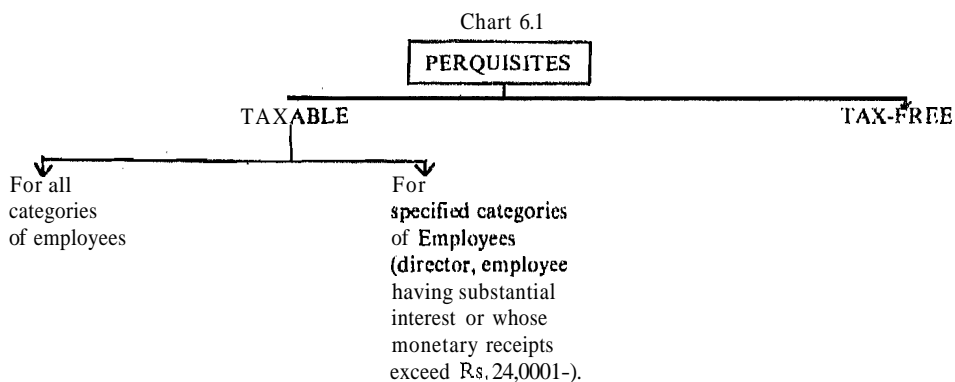
- i) Motor Car
- ii) Gas, electricity and water
- iii) **T**ransport
- iv) Free education to employee's children in employer's institution
- v) Sweeper, watchman, gardener, etc.
- vi) Refrigerator, heater, etc.
- vii) Facilities of free boarding and lodging at Holiday Homes
- viii) **I**ssue of shares at a concessional price
- ix) Free lunch.

C) **ax-free** Perquisites for **all** Categories of Employees :

- i) Medical benefits. The reimbursement of medical expenses or provision of medical facilities will be taxable only in excess of **Rs. 5,000 p.a.** (Circular No. 376 dated 6.1.1984.) However, medical facilities free of charge or reimbursement of medical expenses such as, operation fees, hospitalisation charges and cost of medicines, tests, etc. actually incurred in India by the employer on an **employee**, including Managers/ Directors, and his family members will not be treated as perquisite provided this expenditure is incurred on medical treatment in a recognised public hospital in India (Circular No, 441 F.No. 200/177/84-IT(A-1) dated 31.12.1985).

- ii) Refreshment during working hours in office premises.
- iii) Free telephone at the residence of the employee even though it is partly used for private purposes.
- iv) subsidized lunch or dinner provided during working hours.
- v) Recreational facilities.
- vi) Amount spent by the employer on refresher course training of the employees.
- vii) Goods sold by the employer to his employees at **concessional** rates.
- viii) Conveyance facility to employees from their residence to office and **vice versa**.
- ix) Free travel passes issued by Railways to its employees and their family members.
- x) Leave travel concession— Subject to a limit.
- xi) Employer's contribution to staff group insurance scheme.
- xii) Perquisites allowed outside India by the Government to its employees who are rendering services outside India.
- xiii) Value of free rations given to the armed forces personnel.
- xiv) **Value** of the facilities of promoting family planning among the employees.
- xv) Value of rent-free official residence, conveyance facilities and sumptuary allowance provided to the High Court and Supreme Court judges.
- xvi) Value of rent-free furnished residence (including **maintenance** thereof) provided to a Minister, an Officer of Parliament or a Leader of the Opposition in Parliament.
- xvii) Scholarship given by the employer to children of the staff members is not a perquisite to the employees. If it is treated as a perquisite, it is exempt u/s 10(6). [CIT v M.N. Nadkarni (1986) 161 ITR 544].

THE CLASSIFICATION WILL BE MORE CLEAR WITH THE HELP OF THE FOLLOWING



Check Your Progress A

- 1) State whether the following is a taxable perquisite for all employees, taxable for specified employees or tax free.
 - i) Refrigerator & heater provided by the employer
 - ii) Leave Travel Concession
 - iii) Training of employees on employers expenses
 - iv) Educational expenses of children of employee
 - v) Free education of employee's children in employer's institution.....

2) What do you mean by 'monetary income'?

.....

.....

.....

3) Who is a 'specified employee'?

.....

.....

.....

6.3 VALUATION OF PERQUISITES—ALL EMPLOYEES

For the purpose of computing the income chargeable under the head "Salaries" the value of the perquisites, not provided by way of monetary payment to the assessee shall be determined in accordance with the provisions of Rule 3 of Income Tax Rules, 1962.

6.3.1 Rent Free Accommodation—Rule 3(a)

An employer can provide his employee with rent-free accommodation which may be furnished or may not be furnished. For the purpose of determining the value of this perquisite, employees have been divided into three broad categories:

- A) Government Employees
- B) Semi-Government Employees
- C) Employees of Private Sector

A) Government Employees :

The following types of employees are included in this category:

- a) Central and State Government employees.
- b) Government officials who have been deputed to a body or undertaking under the control of the Government, occupying residential accommodation allotted to that body or undertaking by the Government.

i) Unfurnished accommodation :

The value of furnished rent-free residential accommodation is determined as follows. The type of employees is taken to be the rent which has been or would have been determined as payable by him in accordance with the rules framed by the government for allotment of residence to its officers.

ii) Furnished accommodation :

The value of furnished rent free-residential accommodation is determined as follows.

Value of unfurnished rent-free residential accommodation, as per (1) above.

Add 10% per annum of the original cost of the furniture (including television sets, refrigerators, other household appliances and air-conditioning plant or equipment)

OR

If the above furniture is hired add the actual hire-charges

..... —
.....

Value of furnished rent-free residential accommodation

..... —
.....

The value of rent-free residence provided to the following persons is totally exempt from income tax.

- i) Judge of a High Court or Supreme Court.
- ii) A Minister, an officer of Parliament and a leader of the opposition.

Look at Illustration No. 1 and see how the value of rent-free unfurnished and furnished accommodation is calculated for Government Employees :

Illustration 1

Mr. Y is an I.A.S. Officer in the Ministry of Home Affairs, New Delhi. He draws a basic pay of Rs. 6,000/- p.m. and dearness allowance of Rs. 1,200/- p.m. 50% of which is taken into account for computing retirement benefits. He is provided a rent-free house at Jor Bagh the fair market rent of which is Rs. 48,000/- p.a. However, as per Government rules the rent payable by Mr. Y is fixed at Rs. 9,600/- p.a. Determine the value of rent-free accommodation if the house is (i) unfurnished (ii) furnished and hire charges of furnishing are Rs. 2,000/- p.a.

Solution

- 1) In the case of a government employee, the value of rent-free unfurnished house is taken to be the rent which is payable by the employee as per rules framed by the Government. The fair market rent or the salary drawn by the employee are

not at all relevant. Hence in the present case the value of rent-free unfurnished accommodation is Rs.9,600/-.

ii)	Value of rent-free furnished accommodation	= Rs. 9,600.00
	Value of rent-free unfurnished Accommodation	= Rs. 2,000.00
	Add Hire charges of Furnishing	
		<u>Rs. 11,600.00</u>

B) Public Sector Employees or Semi-Government Employees

The following types of employees are included in this category:

- i) Employees of Reserve Bank of India.
- ii) Employees of a statutory corporation (established by a Central, State or Provincial Act) or a company in which all shares are held (whether singly or taken together) by the government or the Reserve Bank of India or by a Corporation owned by that Bank.
- iii) Employees of a company which is 100% subsidiary of a statutory corporation or a company referred to in (ii) above.
- iv) Employees of a body or undertaking including a registered society (under the Societies Registration Act, 1860) financed wholly or mainly by the Government. This covers the employees of a University or other recognised educational Institution.
- v) Officers of the Government whose services have been lent to or who are employed after retirement from Government services with any company in which not less than 40% of the shares are held (whether singly or taken together) by the Government or the Reserve Bank of India or a corporation owned by that Bank.

a) Unfurnished accommodation

The value of unfurnished accommodation will be determined as follows:

- i) 10% of salary due for the relevant period i.e. the period during which the accommodation was occupied by the employee; or
- ii) Fair rental value of such accommodation, whichever is less.

However it is necessary for the assessee to make a specific claim and the Assessing Officer should be satisfied that 10% of salary due exceeds the fair rental value. Then the value will be limited to the fair rental value.

Definition of 'Salary'

For valuing the above prerequisite the term salary includes the following:

- a) basic pay.
- b) dearness pay/dearness allowance if the terms of employment so provide i.e. if they are taken into account for determining the Provident Fund Contributions and Gratuity.
- c) bonus, fees
- d) commission payable monthly or otherwise. Thus any type of commission whether or not based on turnover achieved by the employee is included
- e) all other taxable allowances (excluding the exempted portion). For example in respect of HRA that portion of HRA exempt under Section 10(13 A) is to be excluded.
- f) income tax or profession tax paid by the employer on behalf of the employee— CIT v I.G. Mackintosh (1976) 99 ITR 419 (Mad),
- g) Value of electricity, gas, water expenses paid or reimbursed by an employer to his employees—CIT v C.M. Steel (1972) 86 ITR 821 (Ker).

Salary 'due' is to be the basis: Here 'salary' means salary due for the period during which the accommodation was occupied. For example if an employee draws during the current previous year advance salary which will be due only in the next previous year that cannot be included in the salary for valuing this prerequisite. This is because the advance salary is not for a period during which the accommodation was occupied. Similarly salary due at the end of the previous year, even if received only in the next year, has to be included.

During the period of occupation of the house, if salary is due to the employee from more than one employer, the aggregate salary due has to be considered even if the house has been provided only by one employer. CIT v Mohanlal Jalan (1989) 176

LTR 478 (Bom).

'Salary' does not include the following :

- a) dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee.
- b) employer's contribution to the **provident** fund account of the employee.
- c) allowances which are exempt from tax.
- d) entertainment allowance to the extent deductible from salary.

It is of course, clear that the value of perquisites will not be considered as part of salary for this purpose.

Fair rental value

- 1) This means the rent which a similar accommodation would realise in the same locality or the municipal valuation of the accommodation, whichever is higher.
- 2) Where, however, a Rent Control Act is in operation the fair rental value cannot exceed the standard rent determined or permissible under that Act. **Dewan Daulat Ram Kapoor v New Delhi Municipal Committee (1980) & SCR 607** and **Mrs. Shiela Kaushik v CIT (1981) 7 Taxman 1**. This rule will not of course be applicable to such accommodation in respect of which Rent Control Act is not applicable.
- 3) There are two ways in which an employer can provide rent-free residential accommodation to his employees. Firstly, he himself may be the owner of the house. Secondly, he may rent the house from third parties and provide it free of rent to his employee. In the former case, if the **employer** also provides the services of a gardener, the salary paid to the gardener and the maintenance expenses of the garden and the ground attached to the accommodation are to be included in the fair rental value. (Circular No. 122, dt. October, 19, 1973.)

b) Furnished accommodation

To the above determined 10% of salary or fair-rental value whichever is less, we have to add 10% per annum of the original cost of the furniture (including television sets, refrigerators, other house-hold appliances and air-conditioning plant or equipment).

However, if such furniture is hired by the employer, the actual hire charges payable should be added.

Illustration 2 will help you to understand the calculation of value of rent free unfurnished and furnished accommodation given to public sector employees.

Illustration 2

A is a pilot in Air India. He draws Rs. 72,000/- p.a. as basic pay, Rs. 12,000/- as **D.A.** (not considered for computing retirement benefits), Rs. 6,000/- bonus and Rs. 6,000/- p.a. as educational allowance. He has got two children studying in the nearby school. He is also paid a flight allowance of Rs. 1,500/- p.m. to meet his personal expenses while on duty. He has been provided with a rent-free flat at Santa **Cruz** the fair rental value of which is Rs. 30,000/- p.a. Determine the taxable value of the perquisite if—

- i) the house is unfurnished
- ii) the house is furnished and the cost of furnishing is **Rs. 50,000/-**.

Solution

Let us first calculate the salary of A

Basic Pay	.....	Rs. 72,000/-
D.A. (not to be included in the salary due for determining the perquisite value)		
Bonus		6000/-
Educational allowance	Rs. 6,000/-	
Less exemption specified under Sec. 10(14) . $50 \times 2 \times 12$	Rs. 1,200/-	4,800/-
Flight allowance	Rs. 18,000/-	
Less exemption specified under Sec. 10(14) .		

70% of the allowance or Rs. 1,000 p.m. whichever is less	Rs. <u>12,000/-</u>	<u>6,000/-</u>
		<u>Rs. 88,800/-</u>

- i) Value of rent-free unfurnished accommodation
10% of the salary or fair rental value whichever is less
10% of the salary is Rs. 8,800 ($10/100 \times 88,800$)
Fair rental value is Rs. 30,000.
So the value of rent-free accommodation is Rs. 8,800.
- ii) Value of rent-free furnished accommodation is value of rent-free unfurnished accommodation plus 10% of cost of Furniture
i.e. $8,800 + (10/100 \times 50,000)$
 $= 8,800 + 5,000 = \text{Rs. } 13,800$.

C) Employees of Private Sector

i) Fair rent less than 10% of salary

If the assessee claims and the Assessing Officer is satisfied that the fair rental value is less than 10% of salary for the relevant period, such fair rental value will be the value of the accommodation. The meaning of the terms 'salary' and 'fair rental value' remain the same as in the previous case.

ii) Fair-rent more than 10% of salary

Where the fair-rent is more than 10% of salary then, employees are divided into two categories.

a) Those residing at Delhi, Bombay, Calcutta and Madras:

The value of the perquisite for employees residing in any of these four metropolitan cities will be 10% of salary for the relevant period plus Excess of fair-rental value over 60% of the salary.

b) Those residing in any other place:

The perquisite value will be 10% salary for the relevant period plus excess of fair-rental value over 50% of salary. Hence if the accommodation is situated in the specified cities excess of fair rent over 60% of salary will be added to the basic 10%. If it is situated in any other places the excess of fair rent over 50% of salary will be added to the basic 10%.

Furnished accommodation

To the above determined value in respect of unfurnished accommodation, we have to add 10% per annum of the original cost of the furniture (including television sets, refrigerators, other household appliances and air-conditioning plant or equipment). However if such furniture is hired by the employer, the actual hire charges payable should be added.

Look at Illustration 3 and see how the value of rent-free accommodation of a private sector employee is calculated.

Illustration 3

Mr. Bansal is the Chairman of Hyderabad Tobacco Co. Ltd., Hyderabad. His particulars for the financial year ending 31.3.90 are as follows:

	Rs.
Basic Pay	10,000/- p.m.
D.A. (not considered for retirement benefits)	1,000/- p.m.
Bonus for the year	12,000/-
Arrears of earlier years' bonus	10,000/-
Commission on profits for 89-90	60,000/-
Advance salary for April PO drawn in Mar 90	10,000/-
Employer's contribution to provident fund	12% of salary
Profession tax paid by the company	1,000/- p.a.
Income tax paid by the company	5,000/- p.m.
Electricity bills for the year paid by the company	Rs. 5,000/-
Fees for attending board meetings	Rs. 3,000/-

His two children are studying in Doon School, Dehradun the education expenses during the year being Rs. 20,000/- fully met by the company. He has also been given

a spacious bungalow in Banjara Hills free of rent. The company owns the bungalow. The fair rental value of the bungalow is Rs. 8,000/- p.m.

There is a swimming pool inside the bungalow compound the maintenance cost of which was Rs. 10,000/- for the year, met by the company. The garden inside the compound wall is maintained by the company. The gardener is paid a salary of Rs. 600/- p.m. The maintenance cost came to Rs. 5,000/- during the year. The chairman has also been provided with a security and a sweeper whose salaries amounting to Rs. 500/- p.m. and Rs. 400/- p.m. respectively have been paid by the company. The entire bungalow is richly furnished with furniture costing Rs. 1,50,000/-.

Determine the perquisite value of the rent-free bungalow in the hands of Mr. Bartsal.

Will your answer be different if the company does not own the bungalow but rents the same for Rs. 8,000/- p.m. and provides it free to the Chairman?

Solution

	Rs.
i) Salary due:	1,20,000/-
D.A. (not to be included only for the specific purpose of calculating salary due)	12,000/-
Arrears of earlier years' bonus cannot be included in salary since the arrears, even though taxable in this year on receipt basis, relate, to an earlier period other than the period during which the accommodation was occupied by the employer during the previous year.	60,000/-
Commission on profits	60,000/-
Advance salary for April 90 drawn in March 90 even though taxable on receipt basis cannot be included in salary for the same reason as explained for bonus.	—
Employer's contribution to Provident fund account— not to be included even if it exceeds 10% of salary.	—
Profession tax paid by the company.	1,000/-
Income tax paid by the company	60,000/-
Electricity bills paid by the company.	5,000/-
Fee for attending board meetings— not to be included since it is not income from salary.	—
Education expenses met by the company.	20,000/-
Perquisite value of sweeper, gardener and watchman is to be calculated separately and included, in taxable salary income but not to be included in salary due for the purpose of ascertaining the value of rent-free house	2,78,000/-
ii) Fair Rental Value	
Fair rental value*	Rs. 96,000/-
Add Gardener's salary	Rs. 7,200/-
Maintenance cost of garden	Rs. 5,000/-
Maintenance of swimming pool	Rs. 10,000/-
	1,18,200/-

iii) Value of perquisite 10% of salary	Rs. 27,800/-
Since Mr. Bansal is in a place other than Bombay, Calcutta, Delhi, and Madras the excess of Fair rental value over 50% of salary due is to be included in the perquisite value. Rs. 1,18,200/- — Rs. 1,39,000	= Rs. Nil
Add 10% of the Original cost of furniture	<u>Rs. 27,800/-</u> <u>Rs. 15,000/-</u> <u>Rs. 42,800/-</u>

If the company rents the bungalow for Rs. 8,000/- then, gardener's salary, maintenance cost of garden and swimming pool will not be included in the fair rental value, Hence Rs. 96,000/- will constitute the rental value and the same is less than 50% of salary due. The final answer will therefore, remains the same.

Where the employee pays fair rent then there is no question of any concession arising in this regard. Thus the value of the perquisite will be nil.

6.3.2 Accommodation at Concessional Rent—Rule 3(b)

Where the accommodation is provided to the employee at a concessional rate of rent, the value of such accommodation is first determined as if the accommodation were provided free of rent (as explained earlier). From the above value, the rent paid or payable by the employee for the period during which he occupied the house during the previous year, should be deducted. The resulting amount will be added to his salary as value of-concession.

6.4 VALUATION OF PERQUISITES—SPECIFIED EMPLOYEES

As discussed in Section 6.2, there are certain perquisites which are taxable in case of specified employees. i.e. directors of a company, person having substantial interest in the company or a person whose monetary salary exceeds Rs. 24,000/-. Let us now discuss in detail how the value of such perquisites is calculated.

6.4.1 Motor Car

When an employer owns a motor-car or hires the same and provides it to his employee, it becomes a perquisite in latter's hands. Its value is to be charged under Section, 17(2) (iii) only in the hands of specified.

Where, however, the motorcar is owned by the employee but the employer meets the maintenance cost, then it is not a perquisite in kind but an obligation of the employee discharged by the employer. The value of the obligation is always chargeable in the hands of employee whether he is a specified employee or not.

The provisions of Rule 3(c) regarding valuation of perquisite of car may be summarised as follows :

Usage	Running and maintenance cost fully met or reimbursed by the employer	Running and maintenance cost fully met by the employtr.
-------	--	---

A. Where the car is owned or hired by the employer—17(2) (iii)

- | | | |
|-------------------------------------|--|-----------------------------------|
| 1) Used fully for official purposes | No perquisite arises | No perquisite arises |
| 2) Used fully for personal purposes | a) Running and maintenance cost i.e. petrol, repair etc. + | a) Depreciation or hire charges + |

	b) Depreciation (if owned by the employer) or hire charges +	b) Salary of chauffeur if provided by the employer.
	c) Salary of chauffeur if provided by the employer.	
3) Used partly for official use and partly for personal use .	Proportionate share of a + b + c above attributable to private use .	Proportionate share of a + b above attributable to private use.
	OR	OR
	Where it is difficult to work out the above proportion.	Where it is difficult to work out the above proportion
	i) Rs. 300 p.m. (where horsepower (h.p.) rating does not exceed 16) or Rs. 400 p.m. (where h.p. rating exceeds 16) plus	i) Rs. 100/- p.m. (where h.p. rating does not exceed 16) or Rs. 150/- p.m. (where h.p. rating exceeds 16) plus
	ii) Rs. 150 p.m. for salary of chauffeur, if any.	ii) Rs. 150/- p.m. for <i>salary</i> of chauffeur, if any.

B. Where the car is owned or hired by the employee—17(2) (iv)

1) Used fully for official purposes	No requisite arises	No requisite arises
2) Used fully for personal purposes	Actual expenditure borne by the employer	No requisite arises
3) Used partly for official use and partly for personal use	Reasonable proportion of expenditure borne by the employer which in the opinion of the Assessing Officer can be attributed towards personal use.	No requisite arises

C. Where motor-cycle or scooter or any other conveyance is provided by the employer

1) Used fully for official purposes	No requisite arises	No requisite arises
2) Used fully for personal purposes	Running and maintenance cost + Depreciation or hire charges.	Depreciation or hire charges
3) Used partly for official use and partly for private use.	Reasonable share of expenditure borne by the employer which in the opinion of the Assessing Officer can be attributed towards personal use.	Proportionate share of depreciation of hire charges

Note :

- i) Where no particular car is placed at the disposal of the employee but he is allowed to use one or more cars out of a pool of cars owned or hired by **the** employer, the requisite value will be calculated **as if he has been provided with a separate car**. All rules relating to **h.p.** chauffeur's salary etc. will be applied on the above basis.
- ii) If a car **is** provided at a concessional rate, the valuation will be made according to the above rules as if the employee had been provided a **free** motor-car and the amount so computed will be reduced by the amount charged by the employer for the use of the car.
- iii) Where transport facility is provided by the employer for a group of employees **for** going from residence to the place of work or from such place back to residence requisite under Section 17(2) (iii) would be taken to be nil.

The use of any vehicle provided by an employer for journey by the **assessee** from his residence to his office or other place of work or from such office or place to his residence will not be regarded **as a** **perquisite**.

Illustration 4

In the following situations in regard to Mr. A, determine the requisite value of motor-car for the assessment year 1990-91. Ascertain the above value on the assumption that (a) A is a specified employee [i.e., he is (i) a director—employee of a company (ii) a substantially interested employee of a company (iii) an employee drawing more **than Rs. 24,000/-** by way of monetary salary and] b) A is not a specified employee.

- 1) A **uses his** own car fully for official purposes. The cost of maintenance and depreciation comes to **Rs. 8,000/- p.a.** to his employer.

- 2) A uses his own car for personal purposes. He meets the petrol cost which amounting to Rs. 5,000/- and the employer bears the cost of the maintenance amounting Rs. 3,000/-.
- 3) A uses his own car fully for private purposes. The employer reimburses the entire cost of running and maintenance amounting to Rs. 6,000/-.
- 4) The employer provides his own car to A for his private use. WDV of the car as on 1.4.89 is Rs. 30,000/- . Applicable rate of depreciation is 33 1/3%. The employer spends Rs. 8,200/-, on running and maintenance of the car.
- 5) A uses his employer's car one-third for private purposes and his two thirds for official purposes, other facts remain the same as in 4 above.
- 6) Employer provides own fiat car to Mr. A for his official and personal use. W.D.V. of the car as on 1.4.89 Rs. 36,000/-. Depreciation is admissible at the rate of 33 1/3%. The employer spends Rs. 8,100/- on running and maintenance and pays Rs. 6,000/-, as driver's salary. Expenditure attributable towards private use of the car is 80%.
- 7) Employer provides a car to A for his private purposes. W.D.V. as on 1.4.89 is Rs. 42,000/-. Depreciation admissible at the rate of 33 1/3%. A meets a running and maintenance cost.
- 8) Employer provides car to Mr. A for travelling from residence to office and back from office to residence.

Solution

Determination of the perquisite value of car in the hands of Mr. A in different situations:

Particulars	Situation concerned under	Where A is a specified employee Rs.	Where A is not a specified employee Rs.
1) Mr. A owns the car. Uses it fully for official purposes. Employer meets all costs—No perquisite arises.	—	Nil	Nil
2) Mr. A owns the car. Uses for personal A meets petrol cost and employer meets maintenance obligation.	17(2) (iv)	Rs. 3,000/-	Rs. 3,000/-
3) Mr. A owns the car. Fully used for private purposes. Employer meets entire cost obligation.	17(2) (iv)	Rs. 6,000/-	Rs. 6,000/-
4) Employer owns the car. Use-fully private, Entire cost met by Employer perquisite	17(2) (iii)	Rs. 18,200/- (Rs. 8,200 + 10,000 Dep)	Nil
5) Employer owns the car. Usefully private, entire cost met by 1/3 depreciation Rs. 3333/- 1/3 maintenance Rs. 2733/-	17(2) (iii)	Rs. 6,066/-	Nil
6) Depreciation Rs. 9,600/- Maintenance Rs. 6,480/- Driver's salary Rs. 4,000/-	17(2) (iii)	Rs. 20,880/-	Nil
7) Depreciation Rs. 14,000/-	17(2) (iii)	Rs. 14,000	Nil
8) Statutory exemption No perquisite arises	—	Nil	Nil

Note : It may be noted that when the employee owns the car any payment or reimbursement of expenses by the employer becomes an obligation met by the latter chargeable under Section 17(2) (iv) and hence the value thereof is taxable both in the hands of specified and non-specified employees. But when the car is owned by the employer and is provided to the employee for user it results in a perquisite chargeable under Section 17(2) (iii). In those cases only specified employees will be trapped. Non-specified employees will escape taxation.

6.4.2 Free Lodging and Boarding to Hotel Employees

It is common practice for modern hotels to give free board and lodging to employees whose services are necessary on a continuous basis. The value of **such** free boarding and lodging is to be determined as under :

- i) **Lodging** : If it is unfurnished determine it as per provisions applicable to 'employees of private sector' explained above. For furnishing add 10% per annum of cost of furniture or actual hire charges, as the case may be.
- ii) **Board** : The value of free food is determined in such basis and such amount as the Assessing Officer **considers** fair and reasonable (Circular No. 311 dated 4th August, 1981).

6.4.3 Free Supply of Gas, Electricity and Water—Rule 3(d)

Free supply of gas, water and electricity provided by the employer to the employees for their private purposes is a chargeable perquisite.

When it is chargeable under Section 17(2) (iii) as a perquisite :

Where the supply connection for these facilities is in the name of the employer, any payment by the employer for these facilities for the benefit of the employees is a perquisite taxable only in the hands of specified employees.

When it is chargeable under Section 17(2) (iv) as an obligation met :

Where the supply connection for **gas/electricity/water** is in the name of the employee and the bills thereof are paid or reimbursed by the employer it is an **obligation** of the employee met by the employer. Such payment or reimbursement is taxable in the hands of **all** employees.

Valuation : The taxable perquisite under Section 17(2)(iii) is to be valued as follows:

- i) Where such supply is made from resources owned by the employer without purchasing them from any other outside agency, the value thereof is taken to be nil. For example if Indian Oil Corporation provides free gas supply to its employees the perquisite thereof is nil.
- ii) Where the supply is made by an outside agency, the amount paid by the employer to such agency is the perquisite value.
- iii) Where the Assessing Officer is satisfied that the gas, electric energy or water supply to the employee are also consumed for the purposes of his official duties, the value of the perquisite is taken (a) either, the amount paid on that account by the employer to the agency supplying the gas, electric energy or water or (b) an amount equal to $6\frac{1}{4}\%$ of salary whichever is less, "Salary" for this purpose has not **been** defined. We may however follow the rule that salary includes basic pay plus dearness allowance if it is **considered** for calculating superannuation benefits. Commission paid at a fixed percentage of turnover achieved by the employee can also be included vide **Gestener Duplicator (P) Ltd., v.C.I.T. (1979) 117 ITR 1 (S.C.)**.

A connected question arises. If the employer charges anything from the employee for providing this facility, should it be deducted from the perquisite value? The rule is silent in this regard. It is logical of course to deduct the same from the value of the perquisite.

6.4.4 Free Education—Rule 3(e)

There are two ways in which an employer can provide for the free education of his employee's children.

- I. The employer can run the educational institution by himself for the benefit of all his employees as a group. It is not necessary that such institution should be run for the exclusive benefit of the employees' children. Outside children can of course be admitted. This **results** in a perquisite taxable in the hands of the employee. The value should be determined with reference to the cost of such education to the other students studying in that institution. If, however, such institution is run exclusively for the benefit of employees' children only than the value of the perquisite will be equal to the cost of such education in a similar institution in or near the locality.

It should be noted that the value of this perquisite is chargeable in the hands of **specified** employees only.

2. The employer may pay the amount of fees directly to **the** concerned educational institution, or, he may reimburse his employee. The actual expenditure so incurred by the employer is taken as the value of the perquisite. This value being an **obligation** met is to be included in the salary of both specified and non-specified employees.

Scholarship: Where any scholarship is paid by an employer to any child of an employee, the scholarship **so** paid to the child cannot be **treated** as perquisite to the employee—C.I.T. v. M.N. Nadkarni (1986) 161 ITR 544 (Bom).

Education to **Employees**: Amount spent on free education and training of employees **is** not taxable as a perquisite.

Education allowance: Fixed education allowance paid to employees to meet the cost **of** education of his family members is taxable in all cases. However notified exemption under Section 10(14) can be claimed.

6.4.5 Conveyance Facility by Transport Undertaking—Rule 3(f)

Where any undertaking engaged in carriage of goods or passengers provides transport facility to any employee, dependent family members of the employee or his dependent relatives, either free of charge or at a concessional rate, the same **is** not taxable provided the conveyance used for this purpose is owned by the employer. Thus free passes and privilege ticket orders (**PTOs**) **granted** to railway employees and similar facility made available to the employees of Air India and Indian **Airlines** are not taxable.

6.4.6 Free Sweeper, Watchman, Gardener, etc.

	Where employer owns the house and gives the same to the employee,	Where employer rents a house and provides the same to his employee or where the employee arranges his own accommodation
1) Sweeper	75% salary paid to sweeper or Rs. 601-p.m. whichever is less is taxable	Entire salary paid to sweeper is taxable
2) Watchman	50% of salary paid to watchman or Rs. 601-p.m. , whichever is less is taxable	Entire salary paid to watchman is taxable
3) Gardener	Salary paid to gardener is not taxable as a perquisite. However for calculating fair rental of rent-free house, gardener' wages, maintenance cost of garden and swimming pool are to be added.	Entire salary paid to gardener is taxable
4) Any other Servant	Entire salary paid is taxable	Entire salary paid is taxable.

Note: Where the employee engages the services and where the employee engages the services—Distinction in taxability.

If it is the former case and the employer pays or reimburses the salary then it is an obligation met and falls under Section 17(2)(iv) and is taxable in the case **of** both specified and non-specified employees,

If it is the latter case, it is a perquisite taxable only in the hands of specified employee—Section 17(2)(iii).

6.4.7 Medical Benefits

- i) Not taxable at all: Provision of medical facilities or reimbursement of actual medical expenses by the employer for the treatment of employee including Manager (Director) or the members of his family in a recognised public hospital under CGHS and **CS(MA)** in India **is not** to be treated as a perquisite. There is no monetary limit in this regard. However the Assessing Officer will

examine the genuineness of the expenditure at the time of assessment—Circular No.445 dated December 31, 1985.

- ii) **Taxable beyond Rs. 5,000/-** : In the case of any other, hospital the exemption limit is one month salary of the employee or **Rs. 5,000/-** whichever is higher.

However fixed medical allowance paid is always taxable in the hands of all employees.

6.4.8 Other Perquisites

a) **Holiday home for employees**: Where an employer maintains holiday homes for his employees with boarding, lodging and transport facilities, it is a taxable perquisite only in the hands of specified employees under Section 17(2)(iii). The value thereof cannot be arbitrarily fixed.

Factors like quality, location and extent of accommodation, period of stay, other connected facilities and cost of getting similar facilities from outside sources should be duly considered.

b) **Sale of assets by the employer to the employee at concessional rates**: Where the employer sells any asset to the employee at concessional rate, the value of such concession is taxable in the hands of specified employee under Section 7(2)(iii). However recently views have been expressed that where a company sells an asset like a car, air-conditioner etc. to its employees at their book value, while the market rate may be higher, no perquisite is involved since it is purely a commercial transaction between the parties at an agreed price.

c) **Interest free loan to employer** : If an employer grants interest free loan to any employee, the cost to the employer for arranging such a benefit is a taxable perquisite in the hands of specified employees under Section 17(2)(iii). Thus where the employer borrows money from outside and gives the same interest free to his employee the amount of interest payable by the employer thereon is the taxable value of the perquisite. Where the loan is advanced to the employee out of the employer's own funds, a reasonable sum of interest which the employer has to pay on such amount will be taken to be the perquisite value. However the above perquisite is chargeable in the hands of specified employees only..

d) **Shares issued at concessional rates**: Where shares are issued by a company to its employees at concessional rates, the value of the concession is a taxable perquisite in the hands of specified employees under Section 17(2) (iii).

e) **Any other benefit or amenity—Rule 3(g)** : The value of any other benefit or amenity is to be determined on such basis and in such amount as the Assessing Officer considers fair and reasonable.

6.5 FULLY EXEMPTED PERQUISITES

There are certain other perquisites which are exempt in the hands of all employees. They are enumerated below :

1) Premium paid on personal accident policy

Where an employer pays a premium on a personal accident policy taken by him on the life of the employee, the payment is not a perquisite. It is because the employee has not voluntarily taken the insurance policy and the employee has no vested interest in the policy—CIT v Lala Shri Dhar (1971) 84 ITR 192.

2) Recreational Facilities

Provision of recreational facilities by an employer to groups of employees is exempt from tax. However, the facility should be made available in general and should not be restricted to a few employees. If so restricted, the value thereof is taxable as a perquisite in the hands of specified employees under Section 17(2) (iii).

3) Refreshment during office hours

Provision of refreshments like coffee, tea, cold drinks, snacks etc., to the employees during office hours in the office premises is exempt from tax. The value of subsidised

lunch or dinner provided to employees is also exempt. But free lunches are taxable in the hands of specified employees.

4) Residential Telephone

Where an employer provides a telephone connection to the employee for official use, the payment of telephone bills does not constitute a perquisite in the hands of the **employee**, even if he uses the telephone for personal purposes also. The logic behind this is that it is difficult for the Assessing Officer to segregate personal and official calls.

5) Perquisites to government employees posted **abroad—Sec. 10(7)**

Perquisites paid or allowed outside India by the government to a citizen of India for rendering service outside India are fully exempt from income tax.

6) Fees paid for refresher courses

Expenditure incurred by an employer for providing training to an employee in new management techniques or for improving his knowledge to discharge his official functions in a better way or for sponsoring him for any refresher course or for attending any seminar connected with the business of the employer is not a taxable perquisite even if such expenditure includes boarding and lodging expenses of the employee.

7) Leave Travel Concession—Section 10(5) read with Rule 2 B.

An employee, whether he is a citizen of India or not is fully exempt from tax in respect of the value of leave travel concession provided to him by his employer. The extent of **exemption** is specified in Rule 2 B. which says. The value of any leave travel concession or assistance received by or due to an individual.

- a) from his employer for himself and his family in connection with his proceeding on leave to any place in India is exempt; and
- b) from his employer or former employer for himself and his family, in connection with his proceeding to any place in India after retirement from service or after the termination of his service, is exempt.

This exemption shall be subject to such conditions as may be prescribed (including conditions as to number of journeys **and** the amount which shall be exempt per head) having regard to the travel concession or assistance granted to the employees of the Central Government.

Further the amount exempt under this clause shall in no **case** exceed the amount of expenses actually incurred for the purpose of such travel,

Explanation. In this clause the word 'family' means:

- i) the spouse and children of the individual; and
- ii) the parents, brothers and sisters of the individual, wholly or mainly dependent on the individual.

The Government has announced that **w.e.f.** 1.4.1989 the exemption will be available to an employee in respect of two journeys performed in a block of four calendar years commencing from the calendar year 1986. If such a concession is not **availed** of by an individual during a block of four calendar years, an amount in respect of leave travel concession first availed of by the **individual** during first calendar year of the immediately succeeding block of four calendar years (**i.e.**, the 5th calendar year after the block of four calendar years) shall be eligible for exemption. The concession **shall not** be taken into account for the number of journeys in the aforesaid immediately succeeding block of four years.

Conditions prescribed under Rule 2B

Amount actually incurred on the performance of such travel shall be exempt subject to the following conditions:

- i) Where the journey is performed by rail, an amount not exceeding the air-conditioned second class rail fare by the 'shortest route';
- ii) Where the places of origin of journey **and** destination are connected by rail but the journey is performed by any other mode of transport an amount not exceeding the air-conditioned second class rail fare by shortest route;

- iii) Where the places of origin of journey and destination or part thereof are **not** connected by rail and the journey is performed between such places, the amount eligible for exemption shall be—
 - A) Where a recognised public transport system exists, an amount not exceeding the first class or deluxe class fare, on **such** transport by the shortest route; and
 - B) Where no recognised public transport system exists, an amount equivalent to the air-conditioned second class rail fare by the shortest route, as if the journey had been performed by rail.

6.6 DEDUCTIONS FROM 'SALARIES'

The income chargeable under the head "Salaries" is subject to certain deductions allowable under Section 16. They are

- i) Standard Deduction
- ii) Entertainment Allowance
- iii) **Tax** on Employment

Let us now discuss these deductions in detail :

6.6.1 Standard Deduction—Section 16(i)

- a) With effect from 1990-91 assessment year the standard deduction will be equal to 33¹/₃% of salary or Rs. 12,000/- whichever is less.
- b) 'Salary' for the above purpose has been defined in Section 17(1). It includes all monetary payments and all perquisites.
- c) Even if the employer provides conveyance facility to the employee for personal purposes there will be no restriction on the amount of standard deduction.
- d) Where an employee receives salary from more than one employer, standard deduction is to be computed with reference to the aggregate salary due, paid or allowed to the **assessee** by all the employers. In no case can it exceed the ceiling limit of 33¹/₃% or Rs. 12,000/- whichever is less.
- e) Standard deduction is available to pensioners also.

6.6.2 Entertainment Allowance—Section 16(ii)

Entertainment allowance is normally given to Senior Officers. Entertainment allowance is part of salary. Hence it is first to be included in the salary income. Thereafter a deduction, as explained below, will be allowed.

- i) **Government employee:** The least of the following will be allowed as a deduction:
 - a) Rs. 5,000
 - b) 1/5th of the salary
 - c) amount of entertainment allowance granted during the year.

- ii) **Non-government employee (including semi-Government employee)**

The deduction for entertainment allowance is available to those non-government employees who satisfy the following two conditions:

- a) The employee must have been in continuous service with the present employer from a date prior to 1.4.1955.
- b) He must have been receiving entertainment allowance from his present employer continuously from a date before 1.4.55 till the relevant previous year.

If an employee does not satisfy both the conditions, entertainment allowance is fully taxable.

If both the conditions are satisfied the least of the following is allowed as a deduction :

- a) Rs. 7,500/-
- b) Rs. 20% of salary

- c) amount of entertainment allowance granted during the relevant previous year or
 d) amount of entertainment allowance received during the financial year 1954-55.

'Salary' for this purpose excludes any allowance, benefit or other perquisites.

It may be noted that the prescribed deduction will be available even if the entertainment allowance received is not actually spent or spent for purposes other than entertainment of customers.

6.6.3 Tax on Employment

Any sum paid by the assessee on account of a tax on employment, leviable by or under any law, is allowed as a deduction:

Look at Illustration 5, 6 and 7 and see how taxable income from salaries is calculated.

Illustration 5

A joined PQR Ltd., in 1950. He received Rs. 4,000/- p.m. as basic salary Rs. 400/- p.m. as D.A., Rs. 150/- p.m. as education allowance for two children and Rs. 300/- p.m. as entertainment allowance during the previous year 1989-90. In the financial year 1954-55 he received an entertainment allowance of Rs. 100/- p.m.

Determine the taxable income under the head 'salaries' for 1990-91 assessment year.

Solution

		Rs.
Basic pay		48,000/-
D.A.		4,800/-
Education allowance	1,800/-	
less exemption under Section 10(14)		
$50 \times 2 \times 12$	<u>1,200/-</u>	600/-
Entertainment allowance		<u>3,600/-</u>
Gross salary		57,000/-
Less :		
i) Standard deduction $33\frac{1}{3}\%$ or Rs. 12,000/- whichever is less	Rs. 12,000/-	
ii) Entertainment allowance :		
Least of		
i) Rs. 7,500/-		
ii) Rs. 9,600/- (20% of Rs. 48,000)		
iii) Rs. 3,600/- (allowance received during 89-90)		
iv) Rs. 1,200/- (allowance received during 54-55)	<u>1,200/-</u>	<u>13,200/-</u>
Taxable salary		<u>43,800/-</u>

Let us now take few comprehensive illustrations and calculate the taxable salary of an employee.

Illustration 6

Mr. Naresh is an employee of a private sector company in Bombay and gives you the following information regarding his receipts during the financial year 1990-91. You are required to compute his income taxable under the head salaries for the A Y 1991-92 Salary @ Rs. 3,000 per month for 12 months. Dearness allowance Rs. 600/- per month. (The DA is not eligible for computation of retirement benefits) Bonus Rs. 6,000/-, Entertainment allowance Rs. 6,000/- (prior to 1.4.55 he was receiving only Rs. 250 per month). He is also provided with a rent-free furnished accommodation. The fair rental value of the unfurnished accommodation is Rs. 18,000/-. The cost of furniture in the building is Rs. 10,000/-. A watchman is

by the employer. The employer has also provided him with a chauffeur driven car of 20 h.p. which is used by him partly for his personal use and partly for business purposes. The expenses for running and maintenance for private purposes are, however, met by him. He receives an education allowance of Rs. 450/- per month to meet the cost of education of his three children. He pays school fees of Rs. 100/- each for his first two children, and Rs. 250/- for the third child who is studying in a hostel. A telephone is provided at his residence and the bill thereof amounting to Rs. 3,000/- for the financial year 1990-91 was met by the employer. His wife was operated in a recognized public hospital and the fees and other incidental expenses thereof amounting to Rs. 4,000/- were met by the employer. He is also receiving Rs. 250/- per month as lunch allowance, and is provided with the services of a cook, whose salary of Rs. 200/- p.m. is met by his employer. He pays a tax on employment amounting to Rs. 400 during the year.

Solution

Taxable Income under head salary of Mr. Naresh for the Assessment year 1991-92

	Rs.
Salary @ Rs. 3,000 per month	36,000
Dearness Allowance @ Rs. 600 p.m.	7,200
Entertainment Allowance	6,000
Bonus	6,000
Lunch Allowance @ Rs. 250 p.m.	3,000
Valuation of Rent-Free Furnished Accommodation	5,500
Value of perquisite for Motor-Car	3,600
Children's Educational Allowance	3,000
Salary of Watchman	720
Salary of Cook	2,400
Gross Salary	73,420
Less	
Standard Deduction u/s 16(1)	12,000
Entertainment Allowance u/s 16(ii)	3,000
Tax on employment	400
Taxable Salary Income	58,020

Working Notes

1) Valuation of Rent-free Furnished Accommodation	
10% of Salary Rs. 4,500 (Salary, Bonus and Entertainment Allowance portion not exempt).	4,500
Fair Rental Value	Rs. 18,000
∴ Less 60% of salary	Rs. 27,000
Add 10% cost of furniture	1,000
	5,500

Since FRV is not in excess of 60% salary hence value of perquisite will be taken as 10% of salary only.

- 2) **Value of perquisite for motor-car** : Since he is meeting the cost of running for personal use, value will be taken at Rs. 150 p.m., plus Rs. 150 p.m. for Chauffeur.
- 3) Educational allowance is exempt for 2 children' only at Rs. 50 each, however in case of child staying in a hostel the amount exempt is Rs. 150 per month. Hence in case of Mr. Naresh the exempt amount will be Rs. 150 + 50 = 200. Taxable perquisite is Rs. 250.

Illustration 7

Mr. X is employed in Star Paper Mills. as it Sales Manager since 1962. He furnishes the following particulars for the year ending 31st March, 1991,

Salary Rs. 1,200 p.m.

D.A Rs. 400 p.m.

Entertainment allowance 100 p.m.

He is entitled to a commission on sales @ 2%. Total sale for of the company for the year amounts to Rs. 2,00,000. He owns a car and uses it for official purpose etc. The entire expenditure on the car for the year amounts to Rs. 3,500 out of which an amount of Rs. 2,000 was reimbursed by the employer towards the use of car for official purpose. He is provided with the facilities of free water and electricity by the company, the company paid Rs. 500 during the year for the same.

A servant employed by the company on a salary of Rs. 100 p.m. renders free service to him in his house. He spent Rs. 600 on books of new marketing techniques for improving his performance. He is in receipt of house rent allowance @ Rs. 500 p.m. but the actual rent paid by him is Rs. 1,000 p.m. Calculate in salary income.

Solution

Taxable income under head salary of Mr. X for the Assessment year 1991-92

	Rs.
Salary @ Rs. 1,200 p.a.	14,400
Dearness Allowance @ Rs. 400 p.m.	4,800
Entertainment Allowance	1,200
Commission	4,000
	24,400
Less standard deduction 1/3 of salary or Rs. 12,000 whichever is less	8,133
Total Income	16,267

Working Notes

1) HRA		
Actual HRA	500	500
Actual Rent paid	1,000	
Less 1/10 of salary	120	880
1/2 of salary		600

Hence exempted amount is Rs. 500 therefore no perquisite arises.

2) Since Mr. X's monetary is less than Rs. 24,000 so he is not a specified employee. Therefore the value of perquisites like motor-car, free gas, electricity servant etc is nil.

Check Your Progress B

- 1) State whether following statements are True or False.
 - i) In respect of government employees ten per cent of cost of furniture should not be added while computing the perquisite value of the furnished house.
 - ii) For computing the value of rent free accommodation 'salary' for the entire year should be considered irrespective of the period of occupation of the house.
 - iii) For computing 'salary' for the above purpose exemptions under Section 10 should be allowed.
 - iv) If the house is not owned by the employer, salary of gardener and maintenance expenses of the garden should not be added.
 - v) A is an officer in a five star hotel. He has been given a rent-free room to live in. The perquisite value of the same is 'nil'.
 - vi) Where the employer owns the motor-car used by the employee, the perquisite value in respect thereof is taxable in the hands of both specified and non-specified employees.
 - vii) Gas, supplied free by Indian Oil Corporation to its employees is a taxable perquisite.
 - viii) Medical reimbursement for treatment in private hospitals is fully exempt without any limit.

- ix) X Co. Ltd. sells a car owned by it to one of its directors. The book value is Rs. 20,000. The director takes the car at Rs. 10,000. No perquisite arises in this transaction.
 - x) Value of subsidised lunches is exempt while the value of free lunches is taxable perquisite.
- 2) Gross Salary of A is Rs. 50,000. What is the amount of standard deduction available to A?
 - 3) B is a government employee. His basic pay is Rs. 50,000 and he receives a sum of Rs. 6,000 as entertainment allowance. What is the amount of deduction for entertainment allowance available to him?

6.7 LET US SUM UP

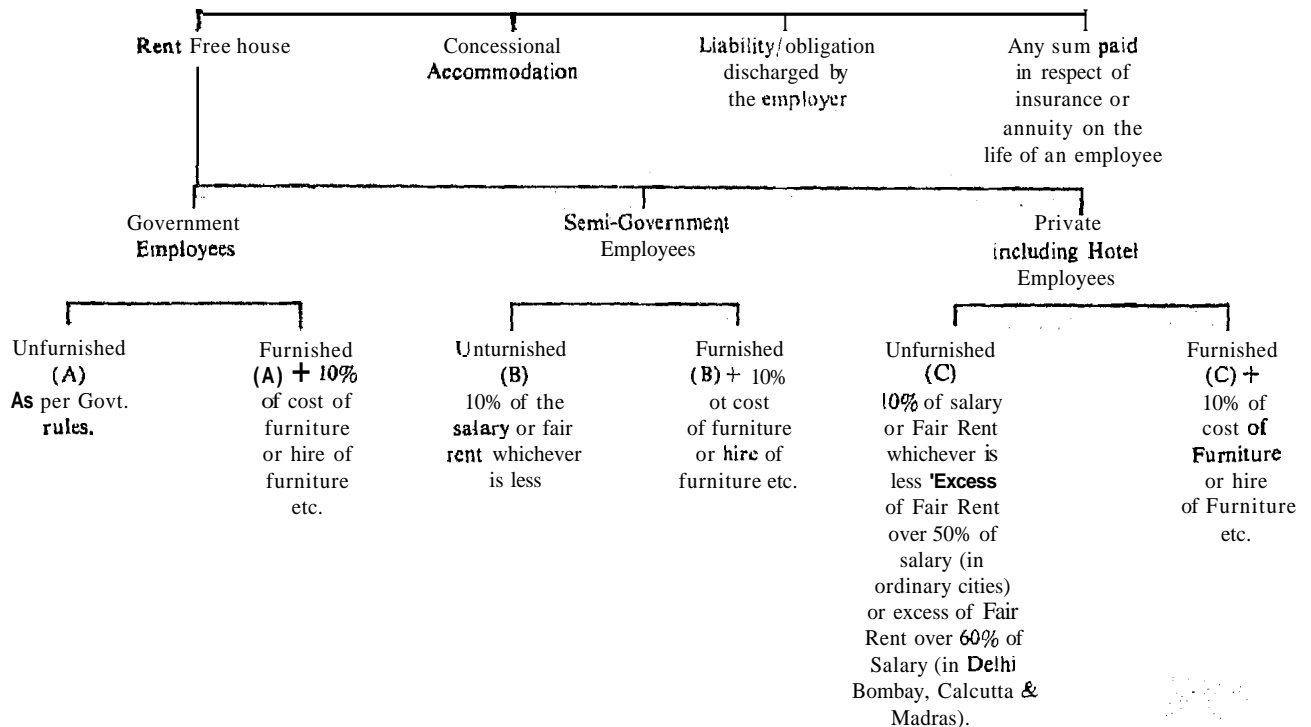
Apart from cash payment an employee also receives certain benefits in kind which can be converted into cash. These are called perquisites. Perquisites may be tax-free, taxable for specified employees, taxable for all employees. These perquisites are to be valued and included in the salary of an employee. Charts 6.2, 6.3 and 6.4 will give the list and valuation of all types of perquisites. After the value of perquisites is calculated and included in the salaried income certain deductions are available from the gross salary. They are

- i) Standard deduction
- ii) Entertainment Allowance
- iii) Tax on Employment.

The net taxable income under the head salary is arrived at after deducting the quantum of permissible deductions mentioned above, from the gross income from salaries.

Chart 6.2

PERQUISITES TAXABLE FOR ALL CATEGORIES OF EMPLOYEES



Note: 'Salary in case of Semi-Government Employees and Private Employees is Basic + Bonus + Commission + Taxable allowance + D.A. if given under the terms of employment or Dearness Pay.

Chart 6.3

PERQUISITES TAXABLE FOR SPECIFIED CATEGORIES OF EMPLOYEES

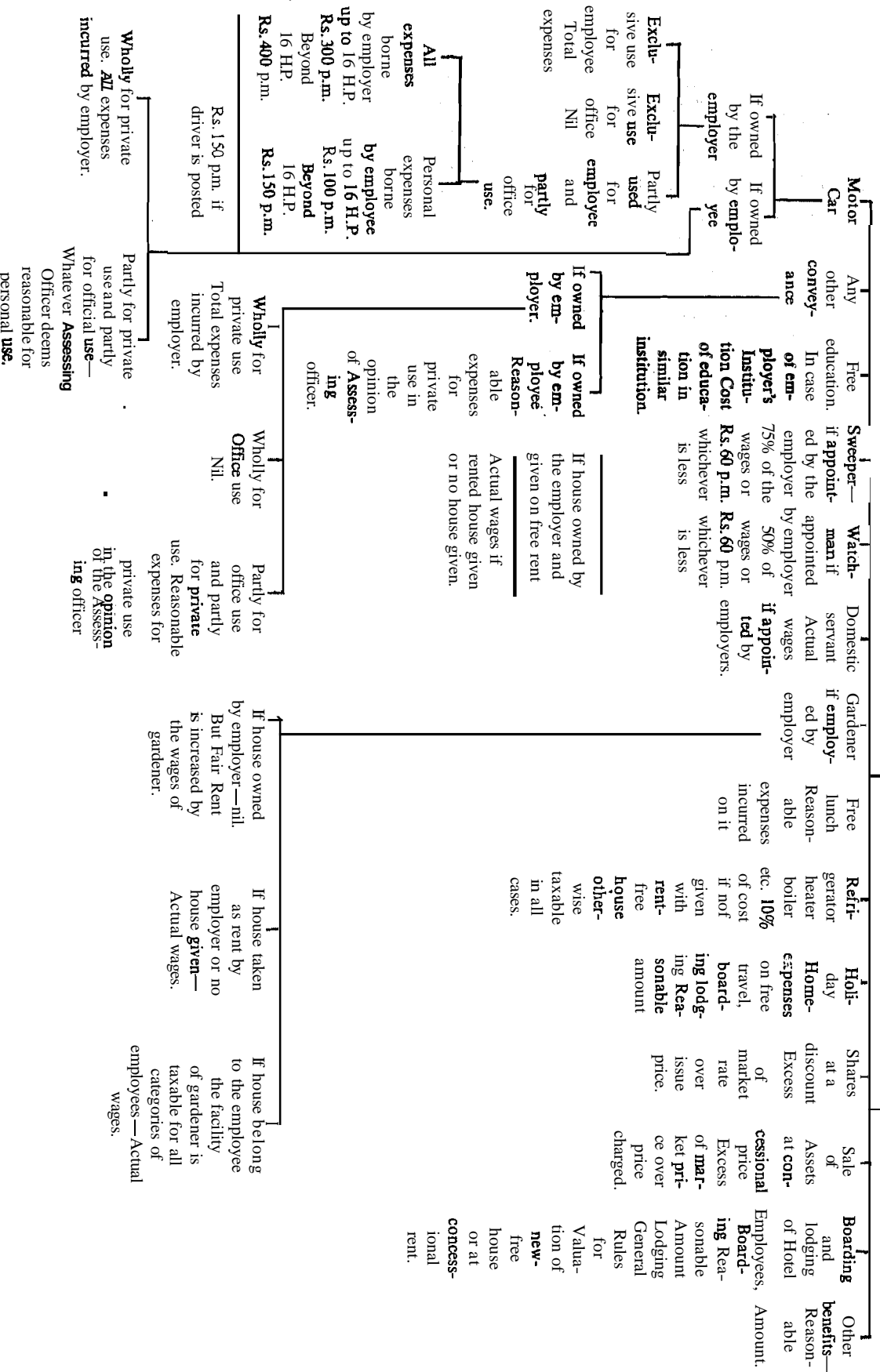


Chart 6.4

TAX FREE PERQUISITES

Free Medical and or reimbur- sement of medical expenses incurred in India in recog- nised Public Hospital, otherwise up to Rs. 5,000	Free Refresh- ment	Recrea- tional Facili- ties	Tele- phone facili- ties	Refre- sher course	Convey- ance Facility from residence to office and vice- versa and also other transport facility by employer engaged in transport business in its own conveyance.	Free Ration to Armed Person- nel	Family Planning Facilities to employ- ees.	Perquisites given to Govt. employ- em. serving abroad.	Rent-Free houses to High Court, Supreme Court Judges, Ministers, Leaders of Opposition	Interest Free loan for construction on purchase of house or any conveyance.	Goods sold to employees at concess- ional rate	Leave Traavel Concession subject to certain rules.
---	--	--	---	---	---	---	---	---	---	--	--	--

- iv) Taxable for all **employees**
 v) Taxable for specified employees
- B 1 i) False ii) False iii) True iv) True v) False vi) False **vii) False**
 viii) False ix) False x) True
 2 Rs. 12,000 3 Rs. 5,000

6.8 KEY WORDS

Accommodation: This refers to the residential house provided to the employee by the employer either free of rent or at concessional rent.

Fair-rental value: This means the rent which a similar accommodation would realise in the same locality or the municipal valuation of the accommodation whichever is higher. Where however, a Rent Control Act is in **operation**, the fair rental value cannot exceed the standard rent determined or permissible under the Act.

Monetary income: This represents **receipts** obtained by a salaried employee by way of money. Obviously perquisites in kind are to be excluded while calculating monetary income.

Perquisite: Payment, fee or profit attached to an office.

Personal accident policy: This is policy usually taken on the life of certain key executives whose functions and **movement** may expose them to fatal accidents or whose existence is for the company's prosperity. The premiums are invariably paid by the employer.

Specified employee: This term denotes those employees who are directors, employees substantially interested in a company or when monetary income under the head 'salaries' exceeds Rs. 24,000.

Standard deduction: It is one of the three statutory deductions permissible under the Act.

6.9 ANSWERS TO CHECK YOUR PROGRESS

- A 1 i) Taxable for specified employees.
 ii) Tax-free
 iii) Tax-free
 iv) Taxable for all employees
 v) Taxable for specified employees
- B 1 **i) False** ii) False iii) True iv) True v) False vi) False **vii) False**
 viii) False ix) False x) True
 2 Rs. 12,000 3 Rs. 5,000

6.10 TERMINAL QUESTIONS/EXERCISES

Questions

- 1) What do you mean by a 'perquisite' and what does it include?
- 2) What is not included in 'salary' for calculating the value of rent-free accommodation for a public employee?
- 3) What are **provisions** of Section 16(ii) regarding entertainment allowance received by a non-govt. employee? .

Exercises

- 1) Compute the monetary income of 'A' from the following particulars for assessment year 1990-1991 to ascertain whether he is a specified employee or not
- Basic pay Rs. 4,000 p.m.
 - D.A. (not forming part of salary for calculating retirement benefits) Rs. 400 p.m.
 - Education allowance Rs. 200 p.m.
 - Income tax paid by the employer on behalf of A Rs. 500 p.m.

(Answer : A is a monetary employee, monetary income Rs. 48,000)

- 2) A and B are joint chief officers in the Reserve Bank of India. The bank has allotted free of rent identical flats to both A and B in Nariman point, Bombay, the fair-market rent of each flat being Rs. 5,000/- p.m. In April '89 A was promoted as chief officer but he continues to occupy the same flat. The Bank has also furnished the above flats. The original cost of furniture provided in each flat works out to Rs. 25,000/-
The salary particulars of A and B are as follows:

	A Rs.	B Rs.
Basic	6,000/- p.m.	4,500/- p.m.
Dearness pay (considered for computing retirement benefits)	750/- p.m.	600/- p.m.
Dearness allowance	500/- p.m.	400/- p.m.
Educational allowance	300/- p.m.	200/- p.m.
Children hostel allowance	300/- p.m.	200/- p.m.
Petrol allowance	600/- p.m.	500/- p.m.

Determine the perquisite value of the flat in the hands of A and B.

Answer: (A) Rs. 11,560; (B) Rs. 9,340

- 3) C is a private sector employee for the previous year ending 31.3.1990. He gives you the following particulars.
- Basic pay Rs. 4,000 p.m.
 - D.A. (not included for computing retirement benefits) Rs. 400 p.m.
 - Bonus Rs. 9,000 for the year
 - Commission (not based on turnover achieved by C) Rs. 3,600 p.m.
 - HRA received Rs. 6,000. Exempted HRA Rs. 3,000
 - Education allowance Rs. 300 p.m. C has got two children.
- C was residing in a house provided by the company during June, 89 to March, 89. Compute 'salary' for the purpose of arriving at the perquisite value of the accommodation.

(Answer: Rs. 54,000)

- 4) From the following particulars determine the fair-rental value of the housing accommodation owned by A Co. Ltd. and given free to its director E.
- | | |
|--|----------------|
| Period of occupation | 9 months |
| Fair market rent | Rs. 5,000 p.m. |
| Standard Rent determined under the Rent Control Act | Rs. 4,000 p.m. |
| Salary of gardener paid by the company | Rs. 500 p.m. |
| Maintenance expenses of the garden and the swimming pool | Rs. 6,000 p.a. |

(Answer: Rs. 45,000)

- 5) Determine the perquisite value of motor-car in the following situations. Assume that A is a specified employee.
- A uses his own car for personal purposes. He meets the petrol cost which amounted to Rs. 5,000 and the employer bore the cost of maintenance amounting to Rs. 3,000.
 - Employer provides a car to A for his private purposes. W.D.V. as on 1.4.89 is Rs. 42,000. Depreciation admissible @ 33 $\frac{1}{3}$ % A meets the running and maintenance cost.

- iii) Employer provides car to Mr. A for travelling from residence to office: and back from office to residence.

(Answer: i) Rs. 3,000 ii) Rs. 14,000 iii) Nil)

- 6) D joined E Private Ltd. in 1950. He received Rs. 5,000 p.m. as basic salary, Rs. 500 p.m. as D.A., Rs. 200 p.m. as education allowance for one child and Rs. 400 p.m. as entertainment allowance during the previous year 1989-90. In the financial year 1954-55 he received an entertainment allowance of Rs. 200 p.m. During the year he paid Rs. 600 as profession tax.

Determine the taxable income under the head 'salaries' for assessment year 1990-91
(Rs. 57,600)

- 7) Ramesh is General Manager of a Limited Company at Rs. 5,000 p.m. as his basic pay. He is provided with a rent-free house for which the company pays Rs. 1,200 p.m. as rent. It has also provided him the necessary furniture costing Rs. 20,000. The company pays Rs. 90 p.m. for electricity and Rs. 90 for the services of a free gardener.

The Company has given him a 16 H.P. car with the chauffeur. He is getting Rs. 800 p.m. as entertainment allowance. He is in service of this company since 1952 and getting Rs. 600 p.m. as entertainment allowance from the beginning, which was increased to Rs. 800 w.e.f. January 1960. Mr. Ramesh himself bears the personal expenses of the car. He is also provided with free lunch in the office costing Rs. 250 p.m. Calculate his taxable income.

(Answer: Rs. 66,908)

- 8) X is working in a private company in Delhi and is drawing a salary of Rs. 4,000 p.m., an entertainment allowance of Rs. 500 p.m., bonus Rs. 10,000.

He is provided with a rent-free furnished house, in respect of which the company pays Rs. 8,000 as rent per annum and Rs. 3,000 as rent for the furniture installed therein. A gardener on a salary of Rs. 125 p.m. is employed by the company. The electricity and water charges of Rs. 800 are also borne by the company. X has his own car which he uses for private purposes. The company pays Rs. 2,000 against the expenses of maintenance of the car. During the year he got Rs. 2,000 reimbursement for medical expenses and Rs. 3,000 by way of L.T.C. The company contributed Rs. 6,000 towards provident fund. X is working in this company for the last 15 years and is getting same entertainment allowance.

Calculate his taxable income.

(Answer: Rs. 65,980)

Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 7 SALARIES—III

Structure

- 7.0 Objectives
- 7.1 Introduction
- 7.2 Provident Fund Schemes
 - 7.2.1 Statutory Provident Fund
 - 7.2.2 Recognised Provident Fund
 - 7.2.3 Unrecognised Provident Fund
 - 7.2.4 Public Provident Fund
 - 7.2.5 Approved Superannuation Fund
- 7.3 Tax Treatment of Provident Fund
- 7.4 Certain other Aspects of Taxable Salary
- 7.5 Deduction under Section 80C
 - 7.5.1 Gross Qualifying Amount
 - 7.5.2 Net Qualifying Amount
 - 7.5.3 Amount of Deduction
 - 7.5.4 System of Rebate from Assessment Year 1991-92
- 7.6 Some Illustrations
- 7.7 Let Us Sum Up
- 7.8 Key Words
- 7.9 Answer to Check Your Progress
- 7.10 Terminal Questions/ Exercises

7.0 OBJECTIVES

After studying this unit, you should be able to

- list different types of provident funds and their treatment for **tax** purposes.
- enumerate and calculate the amount of deductions available **u/s 80C**
- compute the taxable income from salary after taking into account the P.F. and deduction **u/s 80C**

7.1 INTRODUCTION

In Units 5 and 6 we have learnt about the items included in the salaried income of an employee. Apart from many allowances and perquisites there are some other benefits available to a salaried employee. Provident fund is one of such benefits. In this unit we will study in detail the provident fund scheme, different kinds of provident fund and their tax-treatments. We will also study the various deduction available to a salaried individual **u/s 80C** in respect of savings.

7.2 PROVIDENT FUND SCHEME

provident means to provide for future. **Provident Fund** is a fund which is created to help an individual in future. **i.e.**, after retirement or death. The employee contributes a certain amount every month out of his salary an equal amount is contributed by the employee. This amount is invested in government securities and earns a certain amount of interest. The interest so earned on the balance standing in the account of the employee is credited to his provident fund account. This amount gets accumulated over a period of time. The whole amount accumulated over years is given to the employee at the **time** of retirement or voluntary retirement and is paid to the legal heir after the death of the employee. There are different kinds of provident funds. The employee can deposit the amount in any of the provident funds. The different kinds of Provident Funds are:

- i) Statutory Provident Fund
- ii) Recognised Provident Fund

- iii) Unrecognised Provident Fund
- iv) Public Provident Fund
- v) Approved Superannuation Fund

Let us now discuss them one by one.

7.2.1 Statutory Provident Fund

Statutory provident fund is set up under Provident Fund Act, 1925 and is maintained by government and semi-government departments, Reserve Bank of India, State Bank of India, Railways, Statutory corporations, Universities, colleges and local bodies etc.

7.2.2 Recognized Provident Fund

This is a provident fund which is recognized by the commissioner of Income Tax in accordance with the rules contained in part A of the Fourth Schedule to the Income Tax Act 1961. It includes a provident fund established under a scheme framed under the Employees Provident Fund Act, 1952. It must be remembered that it is important for tax purposes. For example where a provident fund is recognized by the PF commissioner but not by the commissioner of Income Tax, then the tax concessions under the Income Tax Act cannot be extended to the contributions to such provident fund.

7.2.3 Unrecognized Provident Fund

This is a provident fund which is not recognized by the Commissioner of Income Tax. Since it is not recognized no relief is granted to the assessee for tax purposes. In other words, it can neither be termed as statutory provident fund nor a recognized provident fund. Such a fund is normally maintained by private employers.

7.2.4 Public Provident Fund (PPF)

Regular salaried employees save money in provident fund through deductions from their salaries. For the benefit of the public particularly for self-employed person such as doctors, lawyers, accountants, actors, traders, the central government introduced the PPF scheme. Individuals and association of persons can deposit in the public provident fund account, as and when their resources permit. Even salaried employees can save through PPF in addition to their regular provident funds. PPF accounts can be opened at any branch of the State Bank of India or its subsidiaries or at any head post office and specified branches of nationalized banks.

Any individual can subscribe to PPF any amount not less than Rs. 100 and not more than Rs. 60,000/- in a year. Interest (which is 12% now) is credited at the end of each year but is payable only at the time of maturity. The accumulated sum in PPF account is payable after 15 years.

7.2.5 Approved Superannuation Fund

This means a superannuation fund approved by the Commissioner of Income Tax in accordance with the rules contained in part B of the Fourth Schedule to the Income Tax Act. It is significant to note that the sole purpose of the above fund should be the provision of annuities for employees on their retirement after a specified age or on their becoming incapacitated prior to such retirement or for the widows or dependants of such employees on their death.

7.3 TAX TREATMENT OF PROVIDENT FUND

In Section 72 you studied the different kinds of provident funds. Let us now study various provisions of Income Tax Act 1961 with regard to these funds. The Income Tax Act lays down provision for

- i) employers contribution
- ii) his own contribution
- iii) Interest on accumulated,

- iv) deduction u/s 80C and
- v) tax liability of accumulated balance payable.

Chart 7.1 will help you to understand the provisions of provident fund relating to five above.

Chart 7.1
Provident Fund and Provisions of Income Tax

	Name of the Fund	Employee's Contribution	Employer's Contribution	Interest credited to the fund	What qualifies for deduction u/s 80C	Tax Liability of the accumulated balance payable of the assessee
1)	Statutory Provident Fund	Included in the salary income	Not included in the salary income	Not included in the salary income	Employee's own contribution	Not included in the salary income
2)	Recognised Provident Fund	Included in the salary income	Only excess over 10% of the salary included in the salary income (i.e. total contribution 10% of the salary)	Only excess over 12% of the rate included in the salary income (Actual rate—12% of the salary)	Own contribution subject to a maximum of 1/5th of salary	Not included in the salary income provided the employer was in continuous service with the employer for 5 years or the discontinuance was due to factors beyond his control
3)	Unrecognised Provident Fund	Included in the salary income	Not included in the salary income year to year	Not included in the salary income year to year	Own contribution is taxable nothing qualifies for deduction	Only employer's contribution and interest thereon is included in the salary income but interest on employees contribution is taxable under the head income from other sources.
4)	Public Provident fund	Included in the total income	Employer does not contribute anything to PPF	Not included in the salary income	Own contribution	Not included in total income
5)	Approved superannuation Fund	Included in the total income	Not included in the salary income	Not included in total income	Own contribution	Not included in total income

Salary for the purposes of provident fund is Basic Salary + Dearness Allowance (if taken for retirement + benefits) + Dearness Pay (excluding all other allowances, bonus and perquisites) + Commission (if based on fixed percentage of turnover achieved and given under terms of employment)

7.4 CERTAIN OTHER ASPECTS OF TAXABLE SALARY

While calculating the taxable income from salary, we should take into account the following aspects of salary:

- 1) **Waivers of salary** : Once salary accrues to an employee it becomes taxable under Section 15. Even if **the employee** waives his right to receive payment thereof it will be considered as a mere application of his income and his tax liability will not be affected.
- 2) **Surrender of salary**: However if an employee surrenders his salary to the central government under Section 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered will be excluded while computing his salary income.
- 3) **Tax-free salaries**: **An employer** can choose to pay the tax on behalf of the employee and refrain from deducting the same from the salary paid to the employee. However while computing the income of the employee, the tax so paid by the employer will be added to the salary income of the employee.

7.5 DEDUCTION UNDER SECTION 80C

(applicable up to 1990-91 assessment year)

Chapter VIA of the Income Tax Act contains several sections which allow deductions from the gross total income to various types of assessees. 'Gross total income' means the total income computed in accordance with the provisions of this Act before making any deduction under the above chapter. In other words, income under each head like salaries, income from house property etc, has to be computed separately and aggregated. The provisions concerning set off and **carry forward** of losses have to be applied. The resulting figure is the gross total income. If the gross total income is nil or a negative figure, there will be no deduction permissible under chapter VIA.

For our **purpose** deductions under Section 80C will be relevant as it allows deductions in respect of payments towards life insurance premium, contribution to provident fund, subscription to National savings certificates etc. In order to compute deductions permissible **under Section 80C** three steps are involved. They are 1) Gross Qualifying Amount 2) Net Qualifying Amount 3) Amount of deduction.

7.5.1 Gross Qualifying Amount

The Gross Qualifying Amount is the amount which qualifies for deduction. The following payments made out of income chargeable to tax are first to be aggregated to arrive at the Gross Qualifying Amount.

- 1) LIC premium paid by an individual to effect or to keep in force an insurance on his own life, life of 'spouse or any child. However, any premium paid in excess of 10% of sum assured will not qualify for deduction. Such excess is to be ignored for the purpose of computation. Payment made by the Government employees to the Central Government Employees Insurance scheme is also to be included for the purpose.

However, where an **assessee** discontinues a policy of life insurance before premiums for two years have been paid no deduction will be allowed in respect of **the** premiums paid in the year in which the policy is terminated. Further, the amount of deduction allowed in respect of the premiums paid in the preceding year or years is deemed to be the income of the **assessee** of such **preceding year** or years and shall be taxed accordingly. For this purpose, the deduction allowed in respect of the **premiums** paid in any previous year or years is the difference between the **amount** by which **the** total deduction actually allowed under this section for that relevant year exceeds the deduction which would have been allowed if no such premium had been paid in that year.

- 2) **Payment** by individual in respect of **incommutable** deferred **annuity** of his **own** life, life of the spouse or any child. It has **been** clarified that contribution for annuity plans under Section **80CCA** i.e., **Jeevan Dhara** and **Jeevan Akshay** Policies do not qualify for deduction under Section **80C**.
- 3) Contribution made **towards** Statutory Provident Fund qualifies fully. Contribution **made to recognised** provident fund qualifies subject to the maximum limit of **1/5** of the salary. Salary for this purpose includes Dearness Allowance if the terms of employment so provide but excludes all other **allowances** and perquisites. If, however, under the terms of contract of employment, commission is determined at a fixed percentage of turnover achieved by an employee such commission **can** be included in salary. Contribution to an approved superannuation fund qualifies fully. **Contribution** to an **unrecognised** provident fund does not qualify.
- 4) Contribution to the Public provident fund, subject to a **minimum** of Rs. 100 and a **maximum** of Rs. 60,000.
- 5) **Contribution** for participating in the 'Unit-linked insurance plan'.
- 6) **Contribution** to Unit Linked **Plan** of the LIC Mutual Fund (**Dhanaraksha 1989**).
- 7) Amount deposited in a **10-year account** under post office savings bank (Cumulative time deposit, **Rules 1959**).
- 8) **Subscription** to National Savings Certificates **VIII since** (w.e.f. 8.5.89). Up to 1989-90 assessment year subscription to **6-year National Savings Certificates VI and VII issues** qualified for deduction. **The sale of the** above certificates **has been discontinued** after **March 31, 1989**. However, interest on **NSC VI issued** purchased up to **31.3.89** is to be **included** in the qualifying amount.
- 4) **Payment for the** construction of residential house. Any specified payment subject to a maximum of **Rs. 10,000** for the **purchase or** construction of a residential house, the **construction** of which is completed after **March 31, 1987** and the income **from** which is chargeable under the head 'Income from house property' will qualify for inclusion in the qualifying amount. If the house is not completed during the **relevant** previous year no deduction will be allowed.

The following are the specified **payments** in this regard:

- a) Any instalment payment or part payment of the amount due under self-financing or other schemes of any development authority, housing boards etc. engaged in the construction and the sale of house property on ownership basis.
- b) Any **instalment** payment or part payment of the **amount** due **to** any company or co-operative society of which the **assessee** is a shareholder or member towards the cost of the house allotted to him.
- c) Repayment of the loan borrowed by the **assessee** from :
 - i) The Central Government or any State Government or
 - ii) **Any** bank including a co-operative bank or
 - iii) The Life Insurance Corporation or
 - iv) Any public company formed **and** registered in India with the main object of carrying on the business of providing long-term finance for the construction or purchase of houses in India for residential purposes and which is approved for creating special reserve under Section **36(i)** (viii) or
 - (v) Any company in **which** the public are substantially interested or any co-operative society where such company or society is engaged in the business of financing the construction of houses or
 - vi) The employer of the assessee, where such employer is a public company or
 - vii) Public sector company or
 - viii) University in its affiliated college or
 - ix) A local authority or
 - x) National Housing Bank
- d) Any payment of **stamp** duty, registration fee and other expenses for the purpose of the transfer of such house property to the **assessee**.

Ineligible Payments

The following payments do not qualify for the purpose of deduction:

- i) Admission fee, cost of **share/initial** deposit which a shareholder of a company or member of a co-operative society has to pay **for** becoming shareholder or member or
- ii) The cost of land, except where the consideration for the purchase of the house property is a composite amount and the cost of land alone cannot be separately ascertained or
- iii) The cost of any addition, alteration, renovation, repair of the house, incurred either after the issue of completion certificate or after the house has been occupied by the **assessee** or any person on his behalf or after the house has been let out or
- iv) Any expenditure in respect of which **deduction is** allowable while computing the **income** from house property.

Where the deduction has been allowed to an **assessee** in any previous year in respect of payments covered under a, b, c or d above and subsequently such sum is refunded or received back by the **assessee** in any previous year, the tax treatment in respect of such refunds will be as follows:

- i) Any money paid in the relevant previous year in which the refund is received will not qualify for **being** considered for **deduction** under Section 80C.
- ii) **The total amount** of the deductions allowed in the previous years preceding the relevant previous year will be deemed to be the **income** of the **assessee** of the relevant previous year in which such refund has been received. Such income will be chargeable as income **from** other sources.

Where the house property so acquired is transferred by the **assessee before** the expiry of 5 years **from** the end of the financial year in which possession of such property is obtained by him, the two tax effects as explained above will follow.

10) : **Deposit with National Housing Bank**

Any deposit made in the **Home Loan** Account Scheme of the National **Housing** Bank qualifies for deduction under Section 80C.

If we add **up** all the above qualifying amounts as explained in 1 to **10**; the total will constitute the gross qualifying amounts as explained in I to **10**; the total will constitute the gross qualifying amount.

7.5.2 Net Qualifying' Amount

The entire gross qualifying amount cannot be considered as eligible for deduction. The act provides upper limits in respect of **the** qualifying amounts. They are as follows:

- i) In the case of an individual being an author, playwright, artist, musician, actor or sportsman **including** an athlete, the qualifying **amount** is either the total of the contribution to the approved savings or Rs. 60,000 whichever is less.
- ii) In the case of any other individual either the total of contribution to the approved savings or Rs. 40,000 whichever is less.

7.5.3 Amount of Deduction

The amount of deduction is computed by applying the **prescribed** rates to the qualifying amount. The prescribed rates are as follows:

- 100% of the first Rs. 6,000 of the qualifying amount
- 50% of the next Rs. 6,000 of the qualifying amount
- 40% of the balance of the qualifying amount

7.5.4 System of Rebate from Assessment Year 1991-92

The Finance Act 1990 has replaced the existing system of allowing deduction from gross total income under Section 80C with a new system of allowing a rebate which will be deducted from the tax payable by the **assessee** on his total income. The rebate

allowable is at the rate of 20% of the qualifying amount. The method of ascertaining the qualifying amount is the same as described above. The items of approved savings also remain the same except for the fact that the ceiling limit of $1/5$ of the salary in respect of contribution to recognised provident fund has been removed.

The deduction by way of rebate of tax cannot exceed the following limits:

- i) In the case of an individual, being an author, playwright, artist, musician, actor or sportsman (including an athlete), Rs. 14,000. In other words they can contribute up to Rs. 70,000 in approved savings to get maximum rebate.
- ii) In any other case, Rs. 10,000. In other words their contribution can be up to Rs. 50,000 to get maximum rebate.

Check Your Progress A

- 1) A person who is a government employee saves the following amount
 - i) Rs. 2,000 as premium on LIC
 - ii) Rs. 3,000 as contribution to Statutory Provident Fund
 - iii) Rs. 4,000 in ULIP
 - iv) Rs. 12,000 as repayment of loan taken for the house
 - v) Rs. 4,000 in Jeevan Dhara,

Calculate (a) the Gross qualifying amount and
(b) Net qualifying amount

- 2) Fill in the blanks
 - i) Interest credited to a **Statutory** provident Fund is.....in the salary income.
 - ii) Own contribution to.....subject to a maximum of $1/5$ of the salary qualifies for deduction u/s 80C
 - iii) A person can deposit Rs. 100 to.....in a year in PPF
 - iv) Contribution to Jeevan Dhara and Jeevan Akshay are entitled for deduction u/s.....

7.6 SOME ILLUSTRATIONS

You have studied the provisions of Income Tax Act regarding different Provident funds. Let us now take a few illustrations to clarify the treatment of provident fund contribution for tax purposes.

Illustration 1

Following particulars are furnished by Mr. Murari, a citizen and resident of India.

	Rs.
a) Basic Salary	36,000
b) Own contribution to Statutory P.F.	5,000
c) Interest credited to P.F. at 12%	3,600
d) House rent allowance (the house is at Kolar and rent paid amounts to Rs. 6,000)	4,200
e) LIC premium paid	8,000
f) Unit Linked Insurance plan contribution paid by employer	1,000

Compute the taxable income of Mr. Murari for 1990-92 Assessment year

Solution

Computation of taxable income of Mr. Murari of assessment year 1990-91

Basic Salary		36,000
House rent allowance:	Rs.	
i) Actual HRA received	4,200	
ii) Rent paid in excess of 10% of salary		
Rs. 6,000—Rs. 3,600	2,400	
iii) 40% of salary	14,400	
Taxable HRA Rs. 4,200—Rs. 2,400		1,800

Employer's contribution to Unit Linked Insurance plan		<u>1,000</u>
(chargeable as a perquisite)		38,800
Less : Standard deduction $33\frac{1}{3}\%$ of Salary or Rs. 12,000 whichever is less		<u>12,080</u>
Taxable Salary being Gross Total Income		26,800
Less : Standard deduction $33\frac{1}{3}\%$ of Qualifying Amount		
PF contribution	Rs. 5,000	
LIC Premium paid	Rs. 8,000	
Contribution to Unit Linked Insurance Plan	<u>Rs. 1,000</u>	
	Rs. 14,000	
Deduction		
First Rs. 6,000 @ 100%	Rs. 6,000	
Next Rs. 6,000 @ 50%	Rs. 3,000	
Balance Rs. 2,000 @ 40%	<u>Rs. 800</u>	
		9,800
Next Rs. 6,000 @ 50%	Total Income	<u>17,000</u>

Since the total income is below the exempted limit of Rs. 18,000 so no tax liability will arise.

Note : Contribution to **statutory provident fund** and interest thereof is not taxable at all.

From assessment year 1991-92 the deductions u/s 80C will not be available as given in the solution the qualifying amount will be calculated as it is. $\frac{1}{5}$ of the qualifying amount will be allowed as a rebate and deducted from the amount of tax calculated on gross total income. i.e., Rs. 2,800 ($\frac{1}{5} \times 14,000$) will be deducted from the tax calculated on Rs. 26,800.

Illustration 2

The following particulars are given by **S. Rajan**, Madras in respect of his annual income for the year ended 31.3.90.

- i) Consolidated salary till 30.9.89 at Rs. 2,500 p.m. and from 1.10.89 Rs. 3,000
- ii) HRA 20% of salary
- iii) Actual house rent paid Rs. 1,200 p.m. However he owns a house property which he has let out
- iv) Contribution to PF by self and employer each 10% of salary
- v) LIC Premium paid Rs. 1,200
- vi) Leave Travel Allowance Received Rs. 2,500. Rs. 2,000 was incurred in travel to home district.
- vii) Medical expenses incurred in treatment of self and family Rs. 5,000. Prepare Rajan's statement of income showing computation of taxable income giving necessary explanation.

Solution

S. Rajan	Previous Year Assessment Year	1989-90 1990-91
Computation of Total Income		
	Rs.	Rs.
1) Salaries		
Consolidated Salary Rs. 2,500 X 6	Rs. 15,000	
Rs. 3000 X 6	<u>Rs. 18,000</u>	33,000
House rent allowance (See Note 1)		Nil
Leave travel allowance—taxable portion		500

(See Note 3)

Less : Standard deduction (Section 16(1))		33,500
Less : Standard deduction @ 33% or		11,167
	Rs.	Rs.
Taxable Salary being GTI		22,333
Less Deduction Section 80C		
PF contribution	3,300	
LIC Premium	1,000	
Qualifying Amount	4,500	
Deduction @ 100%		
(First @ Rs. 6,000, @ 100%)		4,500
Taxable income		17,833
Rounded off to Rs. 17,830/-		

Since this is below the maximum ceiling limit of Rs. 18,000 there will be no tax liability.

Working Notes: 1) Exemption under rule 2A read with Section 10(13A)—HRA	
i) Actual HRA received	Rs. 6,600
ii) Actual rent paid over 10% of salary (Rs. 14,400—Rs. 33,800)	Rs. 11,100
iii) 50% of salary	Rs. 16,600
Exempt HRA	Rs. 6,600
Taxable HRA	Nil

- 2) Shri Rajan, though owns a house property, which has been let out, can claim exemption u/s 10(13A) in respect of HRA as
 - i) Residential accommodation occupied by him is not owned by him
 - ii) He has actually incurred expenditure on payment of rent in respect of the residential accommodation occupied by him.

- 3) Leave Travel allowance to the extent of the amount actually spent on travel to home district has been treated as exempt under Section 10(5) assuming that the fare does not exceed the air-conditioned second class fare by the shortest route to the home district. However, in case where an employer regularly pays a fixed amount as Leave Travel Allowance without any condition whatsoever and without any reference to the amount actually incurred by the employee on this account, the entire allowance is included in salary, without any exemption.

- 4) Reimbursement of medical expenses is entirely exempt since it is not in excess of one month's salary or Rs. 5,000 whichever is higher.

- 5) Employers contribution up to 10% of salary is not taxable,

Illustration 3

Mr. Aggarwal is a professor and head of the department of commerce in Siddarth college, Delhi. His salary particulars are as follows:

Basic pay in April 89		Rs. 7,500
Annual increment (Rs. 250) due on 1st June 89		
Dearness pay forming part of basic pay	200 p.m.	
Additional D.A.	150 p.m.	
Warden allowance	300 p.m.	
Examinership remuneration from various universities		Rs. 4000

The college has provided Mr. Aggarwal a free furnished accommodation. The fair rental value of the house is Rs. 3000 p.m. A free telephone has been installed in his house, Mr. Aggarwal uses the phone both for official and personal purposes.

He spent Rs. 10,000 on a major operation on his wife performed in a hospital in London where his son resides. The managing committee, of the college, as a special case reimbursed Rs. 7,000 towards the above expenses.

During the previous year he along with his family visited **Kanyakumari** by air-conditioned first class sleeper. The train fare amounted to Rs. 10,000. The train fare for air-conditioned second class sleeper by the shortest route to **Kanyakumari** for his family would amount to Rs. 8,000. The college reimbursed Rs. 10,000 to Mr. Aggarwal.

Mr. Aggarwal is a member of the recognised fund maintained by an independent board of trustees. He contributes 12% of his salary as compulsory contribution and 10% thereof a voluntary contribution. The college contributes to his PF 12% of his salary. Mr. Aggarwal was allotted a flat in April 1989 by the **Delhi Development Authority** under self-finance scheme. To meet the cost of the house Mr. Aggarwal had borrowed Rs. 1,00,000 from Delhi University and Rs. 50,000 from Housing Development Finance Corporation. During the previous year the loan and interest repayments are as follows:

	Loan	Interest
HDFC	- Rs. 7,200	Rs. 2,800
Delhi University	Rs. 6,000	Rs. 2,000

During the previous year 1988-89 Mr. Aggarwal deposited Rs. 1,00,000 in a fixed deposit.

Complete the taxable income of Mr. Aggarwal for the assessment year 1990-91.

Solution

Mr. Aggarwal

Previous year 1989-90 Assessment Year 1990-91

Computation of taxable income

Salaries

Basic pay (7500 × 2 + 7750 × 10)	92,500
Dearness pay	2,400
Additional DA	1,800
Warden allowance	3,600

Perquisite value of house

Fair rental value	36,000
10% of salary (92,500 - 24,000 + 1,800 + 3,600 + 2,000)	10,230
Excess of fair rent over 60% of his salary (Rs. 36,000 - Rs. 61,380)	nil
	10,230

Use of telephone for official and personal purpose is not a taxable perquisite.

Reimbursement of medical expenses incurred on his wife in a hospital in London is taxable since the expenses have not been incurred in a recognised public hospital in India 7,000

The exemption available under Section 10(5) in respect of leave travel concession is limited to train fare for air-conditioned second class sleeper by the shortest route to Kanyakumari

The excess fare reimbursed is taxable	2,000
Excess of employer's contribution over 10% of salary	1,898
Income from salary	1,21,428
Less Standard deduction @ 33% or Rs. 12,000 whichever is less	12,000
Taxable Salary	1,09,428

Income from other sources

i) Examinership allowance from various universities	4,000	
ii) Interest on fixed deposit made in wife's name—includible in Mr. Aggarwal's income by virtue of Clubbing provisions of Section 64(1)	11,000	Rs. 1,09,428 <u>15,000</u>
Gross total income		<u>1,24,428</u>
Less Deduction under Section 80C		
Qualifying amounts		
Contribution to PF	11,388	
Contribution to voluntary Provident fund	9,490	
Repayment of housing loan to HDFC and Delhi University qualifying amount limited to LIC premium paid by wife from out of interest on FD limited to 10% of the face value	10,000	
	<u>9,000</u>	
	<u>39,878</u>	
Deduction		
First Rs. 6,000 @ 100%	6,000	
Next Rs. 6,000 @ 50%	3,000	
Balance Rs. 27,878 @ 40%	11,151	20,151
Taxable income		<u>1,04,277</u>
Rounded off to		1,04,280

Working Notes

1) Salary for the Calculation of concession in rent

	Rs.
Basic	92,500
DA	1,800
Dearness Pay	2,400
Warden Allowance	3,600
Taxable portion of LTC	2,000
	<u>1,02,300</u>

10% is Rs. 10,230

2) **Salary** for the purposes of provident fund

	Rs.
Basic	92,500
Dearness Pay	2,400
	<u>94,900</u>

Illustration 4

Mr. Vinod, Manager in **Garwal Paints (P) Ltd.**, Delhi gives you below the details of his income for the year ended **31.3.90**.

Salary from April to March 90, Rs. 48,000. Dearness Allowance (taken **into account** for computing retirement benefits) @ Rs. 1000 p.m. **House** Rent Allowance @ Rs. 750 p.m. (Mr. Vinod is residing in his own residence). Fixed Medical Allowance @ Rs. 250/- p.m.

He was provided with one Motor-car, above **16 h.p.** with a driver which was used **partly** for business and partly for personal use. The **running** and maintenance **expenses** were met by the employer.

He utilised gas, from quick gas service by paying Rs. 1800 which was reimbursed by the employer.

His contribution to unrecognised provident fund was @ Rs. 400 p.m. The employer also contributed an equal sum. Life insurance premium paid by Mr. Vinod during the year amounted to Rs. 8000. Compute his taxable income for 1990-91 assessment year..

Solution

Name of the assessment Shri Vinod, Manager, Garwash Paints (P) Ltd. Delhi:

Previous year ending : 31.3.90	Assessment year 1990-91
Calculation of Taxable Income	Rs.
Basic salary @ Rs. 4000 p.m.	48,000
Dearness Allowance @ Rs. 1000 p.m.	12,000
Fixed Medical Allowance	3,000
House Rent Allowance—fully taxable since Mr. Vinod is staying in his own residence	9,000
Perquisites	
Motor-car exceeding by 16 h.p. with driver @ Rs. 550 p.m.	6,600
Car charge reimbursed by employer—an obligation met by the employer—Hence taxable under Section 17(2) (iv)	1,800
	<hr/> 80,400
Less Standard deduction u/s 16(i) Rs. 12000 or 33 $\frac{1}{3}$ % whichever is less	12,000
	<hr/> 68,400
Taxable salary being Gross total income	68,400
Deduction under chapter VIA 80C : life insurance premium Rs. 8,000	
Deduction	
First Rs. 6,000 @ 100%	6,000
Balance Rs. 2,000 @ 50%	1,000
	<hr/> 7,000
Taxable income	<hr/> 61,400

Note : Employers contribution to unrecognised provident fund is not included for deduction u/s 80C.

Illustration S

A was employed from 1.4.89 for the first time as an assistant marketing manager with Pearl (P) Ltd., New Delhi at a monthly salary of Rs. 4,000 p.m. He was provided with a house by his company and the fair rental value of the house was Rs. 2,000 p.m. He was also provided with furniture and a refrigerator costing Rs. 10,000 and Rs. 6,000 respectively. He contributed Rs. 450 p.m. to an unrecognised provident fund to which his employer also contributed a similar amount.

A resigned the above job on 30.11.89 and joined Pfizer Ltd., Bombay as a marketing manager from 1.12.89 at a monthly salary of Rs. 6,000 and entertainment allowance of Rs. 500 p.m. At that time his contributions to the unrecognised provident fund amounting to Rs. 3,600 and a similar amount representing his employer's contribution and total interest amounting to Rs. 580 were transferred to A's credit in the recognised provident fund maintained by Pfizer Ltd. A contributed 10% of his salary to this recognised PF and the company contributed equally.

Pfizer Ltd. provided the following perquisites to A.

- i) Free furnished accommodation the fair rental value of which was Rs. 30,000
- ii) The original cost of furniture and fittings provided to A was Rs. 30,000
- iii) Reimbursement of school fees of A's son amounting to Rs. 250 per month
- iv) Reimbursement of medical expenses actually incurred by A amounting to Rs. 4000 in total
- v) Free lunch, otherwise costing Rs. 20, for an average of 25 days in a month.

Salaries

On 28.2.90 A resigned the job from Pfizer Ltd., and joined a company in middle east from 1.3.90 on a monthly salary of Rs. 30,000. He therefore got back his provident fund contributions and interest thereon amounting to Rs. 15,000 in April 1990.

Comput. As taxable income for the assessment year 1990-91.

Solution :

P.Y. ended 31.3.1990 **Asst. year** 1990-91

Salaries**(1) Pearl (P) Ltd.**

Salary Rs. 4,000 X 8 32,000

Perquisite value of house

Fair rental value of the house for 8 months Rs. 16,000

10% of salary 3,200

Excess of fair-rental value over 60% of salary (16,000—19,800) nil

10% of cost of furniture and refrigerator for 8 months 1,067 4,267

Employer's share of contribution in the **unrecognised** provident fund now transferred to Pfizer Ltd.

Interest thereon Rs. $580 \div 2$ 3,600

(2) Pfizer Ltd.

Salary Rs. 6000 X 3 18,000

Entertainment allowance—No deduction is permissible under Section 16(ii) Rs. 500 X 3

1,500²

Perquisite value

Rs.

(i) House

Fair rental value for three months Rs. 7,500

10% of salary
(salary = Rs. 18000 + Rs. 1500 + Rs. 600 + Rs.

2,010

Excess of fair rental salary (Rs. 7500—Rs. 12,060)

Nil

10% of cost of furniture for 3 months

750

2,760

Reimbursement of school fees of son for 3 months

750

Less Exemption under Section 10(14) Rs. 50 X

150

600³

Reimbursement of medical expenses is fully exempt since the same is below Rs. 5000/-

Free lunch is not an exempted perquisite whereas free refreshments and **subsidised** lunch is exempted perquisite

Rs. 20 X 25 X 3

1,500

(iii) Salary from middle east

Since A is resident in India during the **previous** year 1989-90, salary received by him in Saudi Arabia for services rendered there is taxable

30,000

(iv) Provident fund dues

A has not completed 5 years of continuous service. His resignation is not due to ill health or factors beyond his control. Hence the amount accumulated in his provident fund account becomes taxable on his resignation on due basis. The date of receipt of the amount is immaterial. However that portion of unrecognised provident fund representing A's contribution and his employer's contribution and interest thereon which have already been included in the taxable income have to be excluded (Rs. 15,000—Rs. 3,600—Rs. 3,600—Rs. 580)

	7,220
	<u>1,01,737</u>
Less Standard deduction	12,000
Taxable Salary	<u>89,737</u>

Income from other sources

Interest credited on the employee's contribution to the unrecognised fund is taxable as income from other sources since it is not covered by the definition 'profits in lieu of salary'. It may be noted that employer's contribution and interest thereon are specifically covered under the above term and hence considered as income from salary

	290
	<u>90,027</u>
Gross total income	
Deduction under chapter VIA section 80C:	
Contribution to recognized P F	Rs. 1800
Deduction @ 100%	<u>1,800</u>
Taxable income	<u>88,227</u>
Rounded off to	88,230/-

Note : For the purpose of allowing 80C deduction the only condition is that the qualifying contribution must have been made out of income chargeable to tax. It is immaterial if the employee withdraws the entire P F balance on his retirement or resignation.

7.7 LET US SUM UP

Provident fund is the main fund in which a person contributes a certain sum and saves money for future benefits. Provident Fund scheme is prevalent in most of the organisations whereby the employer and the employee contribute some amount every month. This amount earns some interest and keeps accumulating over a period of time. At the time of retirement or resignation the total balance in the provident fund account is given to the employee. Provident Funds are of the five types

- i) Statutory Provident Fund
- ii) Recognised Provident Fund
- iii) Unrecognised Provident Fund
- iv) Public Provident Fund
- v) Approver Superannuation Fund

Income Tax Act 1961 lays down provisions of Provident Fund relating to

- i) Employee's Contribution ,
- ii) Employer's Contribution
- iii) Interest on the balance

v) Final payment

Section 80C provides for the deductions relating to savings from gross total income. The savings include LIC premium, PF contribution, Contribution to ULIP, deposits in CTD, repayment of loan on residential house, deposits with national housing bank. All these saving when added amounts to Gross Qualifying Amount, with the help of Gross Qualifying amount to amount of deduction is calculated. This amount is deducted from Gross Total Income to compute the taxable income of the assessee.

7.8 KEY WORDS

Provident Fund : A Fund created to help an individual in future.

Statutory Provident Fund : A Provident Fund maintained by Government and semi-government departments, RBI, SBI Statutory Corporations, universities and colleges.

Recognised Provident Fund : A provident fund recognised by Commissioner of Income Tax whereby any contribution of employer in excess of 10% of salary is taxable.

Unrecognised Provident Fund : A provident fund maintained by private employers and which is not recognised.

Public Provident Fund : A provident fund maintained usually by self-employed persons in a post office or a branch of SBI in addition to the regular provident fund.

Gross Qualifying Amount : Amount of savings that qualify for deduction u/s 80C.

7.9 ANSWERS TO CHECK YOUR PROGRESS

- A 1 a) Rs. 19,000 b) Rs. 11,800
 2 i) not included, ii) recognised provident fund,
 iii) Rs. 60,000 iv) 80 CCA

7.10 TERMINAL QUESTIONS/EXERCISES

Questions

- 1) What are the provisions of Income Tax Act 1961 regarding the Unrecognised Provident Fund?
- 2) What payments are not eligible to qualify for deductions in case of payment of loan taken for construction of a house?

Exercises

- 1) What is the total income of Mr. Bhushan who is posted in Delhi for assessment 1990-91

Basic Salary	50,000
Dearness Allowance	6,500
CCA	1,200
HRA	9,600
Actual rent paid	14,580
Contribution to Statutory Provident Fund	6,500
Investment in ULIP	2,500
Deposits in CTD	1,500

(Answer : Rs. 38,160)

- 2) Mr. Kishori Lal, who is employed in Wikro Ltd. furnishes following information for Assessment year 1990-91

	Rs.
Salary @ Rs. 3,200 p.m.	38,400
Conveyance allowance @ Rs. 300 p.m.	3,600
Education allowance for two children	3,800
Reimbursement of Gas, Water, Electricity charges by the company	1,800

The Company provides him a rent-free accommodation of the value of Rs. 3,000 p.a. He contributes Rs. 5,000 in RPF. The employer's contribution being Rs. 3,800. He has paid Rs. 4,000 by way of premium on his life policy of Rs. 40,000 by him. What is the total income of Mr. Kishori Lal.

(Answer : Rs.26,300)

- 3) Mr. Krishna Rao is employed with a company in Bombay. His basic salary is Rs. 3,500 p.m. His contribution towards recognised provident fund is Rs. 6,000. The employer contributes @ 12.5% of his salary. The interest credited to his P is Rs. 2,000. The accumulated balance to his credit is Rs. 15,000. Two children of Krishna Rao are studying in the institution run by the employer for which no fees is paid. Normal expenditure per student in such institution is Rs. 50 a month. The assessee is provided with a 14 h.p. car which is used for official and private purposes. The maintenance of the car is borne by Krishna Rao.

The Company has also provided him a rent-free unfurnished accommodation, the municipal value of which is Rs. 9,400. Calculate the total income of the assessee for Assessment year 1990-91.

(Answer : Rs. 31,850)

- 4) Following information is furnished by Darshan for the Assessment year 1990-91. Calculate his total Income.

	Rs.
Basic salary	40,000
Dearness Allowance	18,500
CCA	1,200
HRA	4,600
Actual Rent paid @ 800 p.m.	9,600

He contributes 15% of his basic salary to an unrecognised provident fund, the employee contributing 12% of the same. He is also paying Rs. 1500 on his life policy of Rs. 12,000.

(Answer : Rs. 46,500)

Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.)

SOME USEFUL BOOKS

Bhagwati Prasad, Law and Practice of Income Tax; Navaman Prakashan, Aligarh (Chapter 5)

Mahesh Chandra & Goyal S.P., Income Tax Law and Practice, 1990, Himalaya Publishing House, Delhi (Chapter 6)

Mehrotra, H.C. Income Tax Law and Accounts 1990, Sahitya Bhawan, Agra (Chapter 5)

Vinod K. Singhania, Students Guide to Income Tax Taxman Publications Private Ltd. (Chapter 4)

UNIT 8 INCOME FROM HOUSE PROPERTY

Structure

- 8.0 Objectives
- 8.1 Introduction
- 8.2 Income from House Property
 - 8.2.1 Buildings or Land Appurtenant Thereto
 - 8.2.2 Assessee to Pay Tax on Annual Value
 - 8.2.3 Assessee should be the Owner of the House Property
 - 8.2.4 The House Property should not be Used for Assessee's Business or Profession
- 8.3 Income from House Property Exempt from Tax
- 8.4 Some Important Points
- 8.5 Annual Value
- 8.6 Computation of Annual Value
 - 8.6.1 Let Out House
 - 8.6.2 Self-occupied House
- 8.7 Deductions from Annual Value
- 8.8 Computation of Income from House Property
- 8.9 Let Us Sum Up
- 8.10 Key Words
- 8.11 Answers to Check Your Progress
- 8.12 Terminal Questions/Exercises

8.0 OBJECTIVES

After studying this unit you should be able to

- list the incomes chargeable under the head **house** property
- o list the exempted income from house property
- determine the annual value of house property of different categories
- explain the deductions available in respect of income from house property, and
- compute the income chargeable under the head house property.

8.1 INTRODUCTION

Income from house property is the second head of income since the omission of the head interest on securities and its transference to the head 'income from other sources' by the Finance Act, 1988. The provisions of Income **Tax** Act, 1961 regarding computation of taxable income from house property are contained in Sections 23 to 27. The taxable income from house property is not the income actually received as rent but is calculated after making many deductions.

In this unit you will study the incomes chargeable and incomes **exempted under** the head income from house **property**. You will also study how the annual value of the houses of different categories is calculated and what deductions are allowed to compute the income chargeable under the head income **from** house property.

8.2 INCOME FROM HOUSE PROPERTY

According to Section 22 of Income Tax Act, 1961 the **assessee** has to **pay tax** on annual value of the property:

- i) which consists of any buildings or **lands appurtenant** thereto
- ii) which is owned **by the** assessee, and
- iii) which is not used for purposes of **assessee's** business or **profession**.

8.2.1 Buildings or Lands Appurtenant Thereto

House property means buildings or land appurtenant thereto, and the income from such house property is chargeable under the head income from house property. The word 'building' has not been defined by the Act. On the basis of judicial decisions, however, the term building is wide enough to include residential houses, warehouses, auditoriums for entertainment programmes, cinema halls, buildings let out for office use, stadium, open air theatre, dance hall, music halls and lecture halls. Temporary hutments on vacant land are not included in buildings and any income from such hutments is taxable under the head income from other sources. Land appurtenant to building include compound, play ground, kitchen-garden, court yard etc. Land which is not appurtenant to any building does not become house property for the purposes of income tax. That means any rental income from land which is vacant and not attached to building is not chargeable under the head income from house property.

Another point which is to be noted is that the location of the building is immaterial. It may be located in India or abroad; but the income from buildings is taxable under this head of income. However, there are certain exceptions.

Exceptions

- a) Building or staff **quarters** let out to employees and others : Where the **assessee** lets out the building or staff quarters to the employees of business whose residence there is necessary for the efficient conduct of business, the rental income from such employees is not taxable as income from house property.
- b) Building let out for locating bank, post **office**, police station etc. : If building is let out to authorities for locating bank, post office, police station, central excise office, etc. such an income will be assessable as income from business provided the dominant purpose of letting out the building is to enable the **assessee** to **carry** on his business more efficiently and smoothly.
- c) Composite letting of building with other **assets** : Where the **assessee** lets on hire **machinery**, plant or furniture belonging to him and also buildings for a composite rent, and the rent of the buildings is inseparable from the rent of the said machinery, plant or the furniture, the income from such letting is chargeable to income **tax** under the head 'Income **from Other Sources**' or under the head 'Business or Profession', if such letting is his business.
- d) Paying-guest accommodation : It is assessable as business income.

8.2.2 Assessee to Pay Tax on Annual Value

Another important point regarding income from house property is that it is the annual **value** and not the rental value **which** is put to tax. Annual value is calculated by making certain deductions from the rental value, reasonable rent or municipal rent. You will study about the calculation of annual value in detail in Section 8.3.

8.2.3 The Assessee should be the Owner of the House Property

In order that a **house** property may be termed as house property under this head of income, it is necessary that the **assessee** should be the owner of the house property. It is the legal ownership and not the beneficial ownership. He may or may not be the beneficiary but he must **be the** legal owner. **Where** the **assessee** is the lessee of building and he derives income from sub-letting or re-letting, it will not be taxable under this head of **income** but under the head 'Income from Other Sources' where the property is mortgaged, the **mortgager** is the owner and pays tax and not the mortgagee. One point which should be noted is that even if the owner is dealing in the business of letting out of house property, the income therefrom will be charged under Section 22 as income from house property and not under Section 28 under business and profession.

Deemed owner : Section 27 of the Act also provides for certain persons who are not the owners to be treated as deemed owners of house property. These persons have to pay the tax on income from such house property. They include :

- a) an individual who transfers otherwise than for adequate consideration any house property to his or her spouse, not being a transfer in connection with an agreement to live-apart, or to a minor child **not** being a married daughter, shall be deemed to be the owner of the house property so transferred.

- b) the holder of an impartible estate shall be deemed to be owner of the house property.
- c) A member of a Cooperative Society, to whom a building or a part thereof is allotted or leased under the house building scheme of the society, is treated as deemed owner of such property.
- d) a person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in the Transfer of Property Act.
- e) a person who acquires any rights in any building or part thereof by virtue of any such transaction as is referred to in the clause (f) of Section 268 VA (Transfer under purchase by Central Government of Immovable Properties)
- f) a person who takes land on lease and constructs a house upon it.

8.2.4 The House Property should not Used for Purposes of Assessee's Business or Profession

If the property or part thereof is used for assessee's business or profession, the income from which is chargeable to tax, then the annual value of such property or portion will not be taxed under Section 22 i.e. income from house property.

8.3 INCOME FROM HOUSE PROPERTY EXEMPT FROM TAX

There are two kinds of exemptions regarding income from house property: (1) which is totally exempt and (2) which is partially exempt. The first means which is neither included in total income nor taxable and the second means which is included in total income for rate purposes but is not taxed.

First Category : Income house property which is totally exempt :

- i) Buildings situated in the immediate vicinity of agricultural land and which is occupied by the cultivator as a dwelling house or as a store house. It is treated as agriculture income and is fully exempt.
- ii) Any one palace in the occupation of a Ruler.
- iii) House properties belonging to a local authority, scientific research association, University or other recognised educational institution, hospital, or Games or Sports Association and Registered Trade Union.
- iv) Property belonging to an authority constituted under any law for the purpose of marketing of commodities and used for letting of godowns or warehouse for storage of commodities.
- v) House property held by a trust established wholly for charitable purposes.
- vi) House property held by a political party.
- vii) House property owned by an assessee and used for his own business or professional purposes.
- viii) Self-occupied houses — The Finance Act, 1986 w.e.f. 1.4.1987 provide that where the property consists of one house or part of a house in the occupation of the owner for his own residence and is not actually let out during any part of previous year, the annual value of such a house shall be taken to be nil.

Second Category : Income from house property which is partially exempt :

- i) Building belonging to a co-operative society and income derived by it from letting of godowns or warehouses for storage of commodities.
- ii) Building belonging to a co-operative society, where the gross total income of the society does not exceed Rs. 20,000 and the society is not a housing society or an urban consumers society or a society carrying on transport business or a society engaged in manufacturing operations with the aid of power.

8.4 SOME IMPORTANT POINTS

- i) **Income from house property situated abroad** : Income from any house property situated abroad is taxable only in case of an individual. Not ordinary resident and non-resident pay tax on such property only when it is received in India. A resident will pay tax on foreign property as if such property is situated in India.
- ii) **Disputed Ownership** : If the title of ownership is disputed in a court of law, the decision as to who is the owner rests with the income-tax department. Generally, the recipient of rental income or the person who is in possession of the property is treated as the owner.
- iii) **Composite Rent** : If a building is let out to a person along with other facilities (e.g. electricity, cooler, water pump, water tax etc.) for a composite rent and if the rent of the building can be separated from the rent of such facilities, the two rents will be separated and that belonging to the building only will be taxed under the head 'House Property' and that which belongs to other facilities will be taxed under the head 'Income from Other Sources'. If the composite rent cannot be split up it will not be taxed under the head 'House Property', but under the head 'Other Sources.'
- iv) **Property owned by Co-owners** : Where a property is owned by two or more persons jointly and their respective shares are definite and can be ascertained then income from such property shall not be assessed on such persons as association of persons, but the share of each person will be calculated and added to their respective total income.
- v) **Income from sub-letting** : This is chargeable under the head other sources as the person sub-letting is not the owner.

8.5 ANNUAL VALUE

As stated earlier, the assessee has to pay tax on the annual value of the house owned by him. Therefore, it is very important to calculate properly the annual value of the property. According to Section 23 of Income Tax Act, 1961, the annual value of a house property shall be :

- a) the sum for which the property might reasonably be expected to let from year to year; or
- b) where the property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the reasonable rent, the actual amount of rent received or receivable.

Any taxes levied by the local authorities and borne by the owner should be deducted to calculate the annual value of the property.

The above definition makes it clear that annual value of the any house property is its reasonable rent. But, if the actual rent is higher than the reasonable rent then the actual rent received or receivable will be the annual value. It must be noted here that annual value is not determined by actual or reasonable rent alone. In case the rent of house property is fixed by rent controller under the Rent Control Act. The annual value in such a case cannot exceed the rent fixed by the Rent Controller, In case the actual rent exceeds the rent fixed by the rent controller then the actual rent would be the annual value. From the above discussion it is clear that annual value is determined by taking into account many factors. They are:

- i) **Municipal valuation** fixed by the local authorities on the basis of income earning capacity of the property. It is fixed to calculate the house-tax to be paid by the owners.
- ii) **Actual rent** received or receivable from the tenant.
- iii) **Reasonable rent** i.e. the rent of similar properties in the same locality, and
- iv) **Standard rent** the rent fixed by the Rent Controller under Rent Control Act. Where the Standard Rent is applicable reasonable rent and municipal value will

not be taken into consideration even though they are higher than the standard rent.

Check Your Progress A

1) Who are the 'deemed owners' of house property ?

.....

2) What is composite rent ?

.....

3) Tick mark the correct answers.

i) The liability to pay municipal taxes lies with

- a) owner
- b) tenant
- c) lease

ii) The assessee should be

- a) beneficial owner''
- b) mortgagee
- c) legal owner

iii) Which of the following is treated as business income

- a) income from house let out for residential purposes
- b) income from a hall let out for entertainment
- c) income from houses let out to employees

iv) Which of the following income from house property is totally exempt

- a) building of a co-operative society let out for storage of commodities
- b) own house property used for business
- c) income from accommodation given to a paying guest.

8.6 COMPUTATION OF ANNUAL VALUE

When a person owns a house he may occupy it himself or rent it out. The annual value of house property would be different for the house which is given on rent and which is occupied by the owner for his residential purposes. For the purposes of calculation of annual value house property is divided into the following categories:

- 1) House which is let out
- 2) House which is occupied by the owners for residential purposes

Let us now discuss each one of them in detail:

8.6.1 Let Out House

The house which is let out is divided into two categories :

- (A) Which is not covered by Rent 'control Act.
- (B) Which is covered by Rent Control Act.

(A) Which is not covered by the Rent Control Act

The actual rental income or the rent at which it might be expected to be let out or the municipal valuation, whichever is the highest, will be gross annual value. Any municipal taxes or tax levied by any local authority paid and borne by the owner shall be deducted from the gross annual value and the balance left will be the net annual value. The municipal taxes shall be deducted in the year in which they are actually paid, whether for current year only or for the previous year and not on accrual basis. Look at Illustration 1 and see how the annual value of let out house which is not covered by the Rent Control Act is calculated.

Illustration 1

Mr. Ashok is the owner of a house (not covered under Rent Control Act) which is let out at Rs. 1,500 per month. Municipal taxes of the house are Rs. 1,200 (being 10% of the municipal value) out of which Rs. 700 are paid by the tenant. The reasonable rent is Rs. 10,000 per annum. What will be annual value of the house?

Solution

Annual value is the highest of the following three less taxes borne by the owner:

		Rs.
i) Actual rent	(1500 × 12)	18,000
ii) Municipal value	(1200 × $\frac{100}{10}$)	12,000
iii) Reasonable, rent		10,000

Annual value

	Rs.
Actual rent	18,000
Less municipal taxes borne by the owner (1200-700)	500
	17,500

(B) Which is covered by the Rental Control Act

In this case standard rent is fixed by the Rent Controller. The annual value will be the actual rent received or standard rent, whichever is higher. It will be gross annual value. From the gross annual value any municipal taxes or tax levied by any local authority and paid and borne by the owner will be deducted and the balance left will be the net annual value. Look at Illustration.2 for calculation of annual value of a let out house covered under Rent Control Act:

Note : Even if the Municipal value or reasonable rent are higher than standard rent or actual rent, they will not be considered in this case.

Illustration 2

Mr. X is the owner of two houses (covered under the Rent Control Act) which are let at Rs. 1,000 p.m. and Rs. 1,500 p.m. Municipal taxes on these houses are paid by the owner which amount to Rs. 800 and Rs. 1,000 respectively (being 10% of municipal valuation). The Standard Rents fixed under the Rent Control Act are Rs. 14,000 and Rs. 16,000 per annual respectively. What will be their Annual Value?

Solution

Gross annual value is the highest of the following:

	First House Rs.	Second House Rs.
Rent received	12,000	18,000
Standard rent	14,000	16,000

Gross annual value of the first house will Rs. 14,000 and of the second house it will be Rs. 18,000.

Annual Value will be :	First House Rs.	Second House Rs.	Income from House Property!
Gross annual value	14,000	18,000	
Less Municipal taxes borne by the owner	800	1,000	
	<u>13,200</u>	<u>17,000</u>	

Thus annual value of first house is Rs. 13,200 and that of second house is Rs. 17,000.

Statutory Deduction

New houses or units, whose construction commenced after 1st April, 1961, and which are let out for residential purposes are further entitled to statutory deduction from the annual value determined as above. This deduction is allowable for each independent unit of the house separately, as if each unit is a separate house. Each independent unit is that which has separate municipal number, separate electric and water metres and independent latrine; bathroom, kitchen etc. At present, the deduction is relevant for those houses which are completed after 31st March 1982. This deduction is allowed for a period of 60 months from the date of completion. The rate of deduction is as under :

- i) In respect of any residential unit whose annual value as determined does not exceed Rs. 3,600, the amount of such annual value and
- ii) in respect of any residential unit whose annual value as determined exceeds Rs. 3,600, an amount of Rs. 3,600.

Illustration 3 will help you understand the calculation of annual value after allowing the permissible amount of statutory deduction:

Illustration 3

From the following particulars compute the adjusted annual value of a house property for the assessment year 1990-91

- 1) Date of commencement of construction 10th July, 1987.
- 2) Date of completion of construction 1st May, 1989
- 3) Let out for the residential purpose on 1st June, 1989 at the rate of Rs. 600 per month.
- 4) Municipal value of the property Rs. 6,000.
- 5) Annual municipal taxes paid Rs. 400.

Solution

Gross annual value (Municipal value or actual rent, whichever is more)	Rs. 7,200
Less municipal taxes	<u>400</u>
Annual value	6,800
Less statutory deduction	<u>3,600</u>
Adjusted or net annual value	<u><u>3,200</u></u>

Hence, proportionate annual value for 10 months will be

$$= \frac{10 \times 3,200}{12} = \text{Rs. } 2,667.$$

8.6.2 Self-occupied House

The owner of house can

- A occupy the house for full year
- B occupy the house for a part of the previous year and for some part of the previous year it is let out
- C occupy a part of the house for full year and a part for the part of the year (i.e. a part of the house is let out for a part of the previous year).

Let us now see how the annual value of the house is calculated in the above mentioned three cases.

- A i) When the house is self-occupied for the full year**
 The annual value of the house which is occupied by the owner for his residential purposes is nil.
- ii) If a part of the house is self-occupied by the owner for full previous year and a part is let out for full previous year, the annual value shall be determined as under:
- i) From the annual value of the full house the proportionate annual value for self-occupied part for whole year will be deducted;
- ii) the balance left will be the annual value of the let out part for full year.

In case the property consists of more than one house in the occupation of the owner for the purpose of his own residence, the annual value in respect of one such house, which the assessee may choose, shall be taken as Nil. The annual value of the remaining self-occupied houses will be determined as if such houses had been let out. However, in respect these other self-occupied houses, which have been deemed to be let out, the statutory deduction will not be allowed.

- B** If the whole house is self-occupied by the owner for a part of the previous year and the whole house is let out for a part of the previous year, the annual value shall be determined as under:
- i) First of all the annual value of the whole house shall be determined.
- ii) Then the annual value for that period shall be deducted during which the house is self-occupied by the owner.
- iii) The balance left shall be the annual value of the house

Illustration 4 will help you to clearly understand the calculation of the annual value of the house which is self-occupied for a part of the previous year and let out for the remaining part of the previous year.

Illustration 4

From the following information of Mr. A, compute the adjusted annual value of the let out period of the house for the Assessment Year 1990-91.

Municipal value	Rs. 20,000
Municipal tax paid	4,000

House was self-occupied for first six months and for the remaining six months it was let out at the rate of Rs. 2,000 p.m.

Solution

Gross annual value is highest of the following:

	Rs.
Municipal value	20,000
Actual rent (2,000 x 12)	24,000
Gross annual value	24,000
Less municipal taxes	4,000
Annual value	20,000
Less 1/2 of the annual value for self-occupied period	10,000
Adjusted annual value for let out period	10,000

- C** If a part of the house is let out for a part of the previous year or a part of the house property is self-occupied by the owner for full year and a part is occupied by the owner for a part of the year (i.e. a part of the house is let out for a part of the previous year), the annual value shall be determined as under:
- i) First of all from the annual value of the full house, the proportionate annual value of the self-occupied part which is self-occupied for full year shall be deducted.

- ii) From the balance the proportionate annual value for the period during which the remaining part was self-occupied shall be deducted.
- iii) The balance left shall be the annual value for let out portion for the let out period.

Look at Illustration 5 for clear understanding of calculation of annual value of the above mentioned category of houses:

Illustration 5

From the following information of Mr. A, compute the adjusted annual value of the let out portion of the house for the Assessment Year 1990-91.

Municipal value	Rs. 30,000
Municipal tax paid	Rs. 6,000

House is self-occupied but 1/4 of the house is let out @ Rs. 700 p.m. from 1.1.90

Solution

Calculation of Adjusted Annual Value:

	RS.
Gross annual value	33,600
Municipal value	30,000
Actual Rent (700 × 4 × 12)	<u>33,600</u>
Less municipal taxes	<u>6,000</u>
	27,600
Less 3/4 of the annual value for self-occupied portion for full year	<u>20,700</u>
Annual value of 1/4 of the house for full year	6,900
Less 3/4 (ie. $\frac{9}{12}$ of 6,900 for self-occupied portion of the house for nine months	<u>5,175</u>
Part of the house is let out for 3 months	<u><u>1,725</u></u>
Adjusted annual value of part of the house for part of the previous year.	

Note : If the house is newly constructed and is let out for residential purposes during the year, statutory deduction will be allowed as per rules for five years from the date of construction. Such a deduction will be allowed only when the let out portion is an independent unit.

Self-occupied house remaining vacant

If the owner for some reason is not able to stay in the house then the annual value of such self-occupied vacant house would be nil provided the house is not let out and no other benefit is derived from it by the owner in the previous year.

8.7 DEDUCTIONS FROM ANNUAL VALUE

For computing the income chargeable under the head 'Income from House Property', Section 24 provides for the following deductions to be made from the adjusted annual value of house property apart from the deductions regarding local taxes and statutory allowance. They are :

1) Repairs

- a) Where the property is let to a tenant or is deemed to be let out and the owner has undertaken to bear the cost of repairs a sum equal to 1/16th of adjusted

annual value shall be deducted as Repairs Allowance. It is a statutory allowance which is always allowed irrespective of the fact, whether the actual expenditure on repairs is less than or is more than 1/6th of annual value, or whether no amount is spent on repairs or even if the house remained vacant throughout the previous year.

- b) Where the property is in the occupation of a tenant who has undertaken to bear the cost of repairs, the repair allowance shall be limited to either:
 - i) the excess of annual value over the amount of rent payable for a year by the tenant; or
 - ii) a sum equal to 1/6th of the annual value, whichever is less.

Note : If adjusted annual value is less than or equal to actual rent payable during the year, no deduction is allowed in respect of repairs in that year.

Look at Illustration 6 and see how deductions in respect of repairs are made from annual value to calculate income from house property.

Illustration 6

Mr. Ramesh owns a house, whose municipal valuation is Rs. 10,000 p.a. The house is let out at a monthly rent of Rs. 8,200 p.a. to Suresh who undertakes the cost of repairs. Local taxes of Rs. 600 are paid by Mr. Ramesh. Compute the income from house property.

Solution

	Rs.
Gross annual value	10,000
Municipal value	Rs. 10,000
Actual rent	Rs. 8,200
(whichever is higher)	
Less municipal taxes	<u>600</u>
Annual value	9,400
Less allowance for repairs, least of the following two	
i) 1/6 of Rs. 9,600	1600
ii) Annual value	9600
Less actual rent paid	<u>8200</u> '1400
Income from house property	<u>8,000</u>

2) Insurance Premium

Any insurance premium paid on house property against the risk of damage or destruction through any cause, e.g., fire, earthquake, lightning and so on. It is only the actual premium paid that can be claimed as deduction.

3) Annual Charge

If there is an annual charge on the property it is an allowable deduction; but such charge should be legally enforceable and should neither be created, by the assessee voluntarily nor it should be in the nature of capital charge. Thus a revenue annual charge is allowable as deduction only if it has not been created by the assessee voluntarily. It does not include any tax in respect of the property.

4) Ground Rent

The owner of a building may be lessee of the land on which the building is erected. Any ground rent payable in respect of the lease of that land is allowable as a deduction on accrual basis. No deduction is allowed for interest on enhanced ground rent but any additional ground rent paid to regularise the unauthorised use of building is allowed.

5) Interest on Loan Taken in Respect of House Property

Interest on loan taken for the purpose of purchasing, constructing, reconstructing or repairing the house property is allowable as a deduction on

accrual basis. It is not necessary, for the purpose, that the loan so borrowed or the interest payable thereon is secured by a charge on property.

Explanation : Interest payable in respect of funds borrowed for the acquisition or construction of house property and pertaining to the **period prior to the previous year** in which such property has been acquired or constructed, shall be deducted in five equal annual instalments commencing from the previous year in which the house was acquired or constructed.

Illustration 7

Interest on loan of Rs. 40,000 taken on 1.4.1986 at the rate of 10% p.a. to construct a house is Rs. 4,000 for the previous year 1989-90, when the construction of the house was completed. Interest for the preceding three years was also paid but not claimed as deduction.

Compute for the assessment year 1990-91 the amount of interest deductible in computing the income from house property if the house is (i) let out, and (ii) self-occupied.

Solution

	Rs.	Rs.
i) Interest for P. Y. 1989-90	4,000	
Interest for three years prior to the current previous year (during which the construction of the house is completed) Rs. 12,000 deductible in five equal instalments.	<u>2,400</u>	6,400
ii) If the house is self-occupied the deduction shall be allowed to the extent of Rs. 5,000 only.		

6) Land Revenue and Property Tax

- Any sum paid on account of land revenue or any other tax levied by the State Government in respect of the property is deductible.

7) Collection Charges

Any sum spent to collect the rent from the property, not exceeding 6% of adjusted annual value of the property, is allowed as deduction. It includes (i) legal expenses incurred to collect the rent, (ii) salary paid to an employee to collect the rent, (iii) conveyance charges incurred to collect the rent, (iv) postal charges incurred to collect the rent, (v) bank commission to collect the rent.

8) Vacancy Allowance

When the property is let and remains vacant during a part of the year, the part of the adjusted annual value which is proportionate to the period during which the property is wholly unoccupied will be deducted as 'vacancy allowance'.

Where the property is let out in parts, and any part of it remains vacant for a part of the previous year, that portion of the adjusted annual value appropriate of any vacant part, which is proportionate to the period during which such part remains vacant will be deducted as 'Vacancy Allowance'. Where the property remains vacant for full year, no vacancy allowance will be available.

Example

Annual value of the house is Rs. 80,000 and Adjusted Annual Value is Rs. 60,000. A portion of the house fetching rent Rs. 2,000 p.m. remain vacant for 4 months during the previous year, the vacancy allowance would be computed as follows:

In this case, vacancy allowance shall be computed as under:

Rent p.m. X Vacancy period X Adjusted Annual Value of the house

Annual value of the house

$$\text{or } \frac{2,000 \times 4 \times 60,000}{80,000} = \text{Rs. } 6,000.$$

9) **Unrealised Rent**

If the assessée is unable to recover the entire amount of rent due from his tenant in respect of house property let out to him, the unrealised amount of rent shall be deducted from the adjusted annual value of that house, provided that it fulfils the following conditions:

- i) the tenancy is bonafide;
- ii) the defaulting tenant has vacated or legal steps have been taken to compel him to vacate the property;
- iii) the defaulting tenant is not in occupation of any other property of the assessee;
- iv) the assessee has taken all reasonable steps of instituting legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless; and
- v) the annual value of the property to which the unpaid rent relates has been included in the assessed income of the previous year during which the rent was due and tax has been duly paid on such assessed income. This is subject to the limit that deduction to be allowed on this account shall not exceed the income under the head 'Income from House Property' included in the total income as computed without making this deduction. Unrealised rent would be deductible from the income from house property in each assessment year till such deduction is exhausted. From the assessment year 1987-88 no deduction will be allowed in respect of self-occupied property where annual value is nil or in respect of the property which cannot be occupied and whose annual value is nil. However, this prohibition will not hit the deduction of interest on capital borrowed for construction, repairs etc. of self-occupied property if the amount of interest does not exceed Rs. 5,0001-.

8.8 COMPUTATION OF TAXABLE INCOME FROM HOUSE PROPERTY

Computation of income fram house property is done in the following proforma:

Fair Rental Value of the house :	.....
(Actual rent or Municipal value, whichever is higher, or if Rent Control Act is applicable on the house, Standard Rent or Actual Rent, whicli is higher)		
Less i) Local Taxes paid by the owner	.....
ii) Cost of other facilities provided by the owner to the tenant, such as lift, chowkidar etc.	.....
	Annual Value	.....
Less Statutory Deduction for 5 years (In case of newly built house after 31.3.1982 and let out for residential purposes)		.....
	Adjusted Annual Value	.....
Less Deductions:		
i) Repairs Allowance	.....
ii) Insurance Premium Paid	.....
iii) Annual Charge	.....
iv) Ground Rent	.....
v) Interest on Loan taken in respect of house property	.....
vi) Land Revenue paid	.....
vii) Collection Charges paid (restricted to 6% of A.A.V.)	.....
viii) Vacancy Allowance	.....

ix) Unrealised Rent

Taxable Income from House Property

Rs.

Income from House Property

Look at Illustrations 8, 9 and 10 and see how Income from House Property is computed.

Illustration 8

Mr. X owns four houses, the details regarding which are as follows:

- 1) The first house of the annual rental value of Rs. 10,000 was occupied by him for his residence. This house was constructed by a loan, Rs. 7,000 is the interest paid during the year on the same.
- 2) The second house of the annual rental value of Rs. 10,000 was let out for Rs. 12,000 per annum. He claims the following expenses in addition to the statutory allowance for repairs, viz., Rs. 100 for Fire Insurance Premium, Rs. 24 for Ground Rent and Rs. 1,000 for collection charges.
- 3) The third house of the municipal valuation of Rs. 6,000, was let out at Rs. 600 p.m. A loan was taken on 1st April 1985 for the construction of the third house, the construction of which began on 1st May 1985 and ended on 31st January 1987. The house was let out on 1st February 1987. For the previous year 1989-90 the interest paid by him in respect of the loan amounted to Rs. 800 and for the previous years 1985-86 to 1988-89 the interest paid has been Rs. 1,500, Rs. 1,400, Rs. 1,200 and Rs. 1,000 respectively. Municipal taxes were paid @ 10% of municipal valuation.
- 4) The fourth house, the municipal valuation of which is Rs. 6,000 was let out at Rs. 600 p.m. It remained vacant for 4 months. The unrealised rent in respect of this house for past years was Rs. 10,000 which satisfies all conditions for its allowance.

Find out the taxable income from house property for the assessment year 1990-91.

Solution

Computation of Taxable Income from House Property
For the Assessment Year 1990-91

1)	First House		
	Annual value of self-occupied house	Nil	Rs.
	Less Interest on loan upto Rs. 5,000	<u>5,000</u>	
	Loss from the house.....		-5,000
2)	Annual value of the second house.....	12,000	
	Less 1/6th for Repairs	2,000	
	Fire Insurance Premium	100	
	Ground Rent	24	
	Collection charges		
	restricted to 6% of A.V.	<u>720</u>	
		<u>2,844</u>	9,156,
3)	Annual value of the third house	7,200	
	Less Municipal taxes (10% of 6,000)	<u>600</u>	
		6,600	
	Less Statutory Deduction	<u>3,600</u>	
	Adjusted annual value.....	3,000	
1	Less Deductions:		
	1/6th for Repairs	500	
	Interest on loan for		
	P.Y. 1989-90	800	
	115th of interest on loan		
	paid in 1985-86 (P. Y.)	<u>300</u>	
		<u>1,600</u>	1,400
4)	Annual value of the fourth house	7,200	
	Less Deductions:		
	1/6th for Repairs	1,200	
	Vacancy Allowance	2,400	

Unrealised Rent	<u>9,156</u>	<u>12,756</u>	
			Loss from the fourth house
Taxable Income from House Property.....			<u>-5,556</u> Nil

Notes

- 1) In respect of the third house, interest on loan paid in the previous years prior to construction of the house is allowable in five equal annual instalments commencing from the year in which the house is constructed. Here the house was constructed in the P.Y. 1986-87, so the interest for the P.Y. 1985-86 will be allowable in five equal annual instalments commencing from the P.Y. 1986-87 or Assessment Year 1987-88. For the A.Y. 1990-91 fourth instalment of Rs. 300 has been deducted. The interest for P.Y. 1986-87 to 1988-89 would have been allowed fully in the respective Assessment Years.
- 2) The unrealised rent in respect of the fourth house is Ks. 10,000, but the taxable income under the head 'House Property' before making deduction for unrealised rent is $(9,156 + 1,400 + 3,600 - 5,000) = 9,156$. Hence, deduction in this respect is allowed to the extent of Rs. 9,156 only.

Illustration 9

Mr. X owns a house at Kanpur (Municipal value Rs. 20,000) of the fair rent of Rs. 24,000 p.a. During the previous year 1989-90 the house is used by him for his own residence from 1st April 1989 to 30th June 1989 and let out for residential purposes on 1st July 1989 @ Rs. 2,500 p.m. He makes the following expenditure in respect of the house property.

Municipal taxes Rs. 6,000, Repairs Rs. 2,000, Fire Insurance Premium Rs. 3,500, Land Revenue, Rs. 4,000 and Ground Rent Rs. 2,000 were paid during the year. A loan of Rs. 30,000 was taken on 1st April 1986 @ 15% p.a. for the construction of the house which was completed on 1st April 1989. Nothing was repaid on loan account so far. Find out his taxable income from house property for the Assessment Year 1990-91

Solution

	Rs.
Fair Rent being based on actual rent (Rs. 2,500 × 12)	30,000
Less Municipal Taxes	<u>6,000</u>
Annual value	24,000
Less annual value for self-occupied period (114 of 24,000)	<u>6,000</u>
Net annual value	18,000
Less statutory deduction for 9 months	<u>2,700</u>
Net Adjusted annual value	15,300
Less Deductions:	
116th for Repairs	2,550
Fire Insurance Premium	3,500
Land Revenue	4,000
Ground Rent	2,000
Interest on Loan for P.Y. 1989-90	4,500
Add: 115th of interest on loan paid for P.Y. prior to construction, i.e. Rs. 4,500 per year for 3 years, i.e. 1/5th of Rs. 13,500	<u>2,700</u>
	<u>7,200</u>
	<u>19,250</u>
Amount deductible cannot exceed Rs. 15,300 u/s 24(3).....	<u>15,300</u>
Taxable Income from House Property	<u>Nil</u>

Illustration 10

Assume in illustration 8 that:

- a) three-fourth portion of the house is self-occupied for full year; and
- b) one-fourth portion of the house is let out for residential purposes from 1st April 1989 to 31st December 1989 on a rent of Rs. 700 p.m. and from 1st January 1990 it was again used for his own residence.

Find out his taxable income from House Property for the Assessment Year 1990-91.

Solution	Rs.
Fair rent being based on actual rent (700×4×12)	33,600
Less municipal taxes	<u>6,000</u>
	27,600
Less annual value of 3/4 portion which is self-occupied	<u>20,700</u>
Annual value of 1/4 portion.....	6,900
Less annual value for 3 months during which 1/4 portion is self-occupied	<u>1,725</u>
Annual value of 1/4 portion let out for 9 months	5,175
Less statutory deduction @ Rs. 3,600 p.a. for 9 months	<u>2,700</u>
Net adjusted annual value u/s 23(2)(a)(ii)	2,475
Less Deductions:	
116th for Repairs	412
Fire Insurance Premium	3,500
Land Revenue	4,000
Ground Rent	2,000
Interest on loan as determined in the preceding illustration	<u>7,200</u>
	<u>17,112</u>
Amount deductible not to exceed Rs. 2,475 u/s 24(3).....	<u>2,475</u>
Income from House Property.....	Nil

Check Your Progress b

- 1) A is owner of a house (covered under Rent Control Act). He lets out his house to B at Rs. 8,000 per annum. Rent Controller fixes the standard rent at Rs. 9,600. However the municipal value of the house is Rs. 10,000. A pays Rs. 800 as local taxes. What is the annual value of the house ?

- 2) How do you calculate the annual value when the part of a house is let out for a part of the previous year.

- 3) The annual value of a house is Rs. 8,400 and it is let out at an actual rent of Rs. 9,600. What is the amount of deduction available for repairs.

8.9 LET US SUM UP

Income from house property is second major head of income. Income from house property is the annual value of any property which consists of building and land appurtenant thereto, is owned by the assessee and is not used for assessee's business or profession.

Annual value of the property is not the rent received but the reasonable rent, but where actual rent is higher than the reasonable rent the annual value is the actual rent received as reduced by the municipal taxes borne by the owner of the house.

For the purposes of computation of annual value the house property is divided into two:

- i) Let out house
- ii) Self-occupied house.

A house which is let out can either be under Rent Control Act or not. When it is not under Rent Control Act the annual value is actual rent, reasonable rent or municipal value whichever is higher as reduced by municipal taxes paid by the owner. When it is under Rent Control Act the annual value is actual rent or standard rent (as fixed by rent controller) whichever is higher as reduced by municipal taxes paid by the owner.

A self-occupied house can be divided into:

- i) Self-occupied house for full year—annual value is nil.
- ii) Part of the house is self-occupied and a part is let out for full year—annual value is calculated as:
Annual value of the full house for full year less annual value of self-occupied house for full year.
- iii) Full house self-occupied for a part of year and let out for the remaining part of the year. Then, annual value is calculated as follows.

Annual value of full house for full year. Less annual value of full house for the period for which it is self-occupied.

- iv) A part of the house is let out for a part of the previous year, then the annual value is:
Annual value of full house for full year
Less proportionate annual value of self-occupied part for full year.
Less proportionate annual value of self-occupied portion for part of these year.

Statutory deduction is allowed on all the houses newly constructed for five years from the date of completion @ Rs. 3,600 on each independent unit let out. Annual value as reduced by statutory deduction is called adjusted annual value.

Certain deductions are allowed from adjusted annual value to compute income from house property. They are repairs @ 1/6th of adjusted annual value or excess of annual value over rent payable, whichever is less; insurance premium paid; annual charge on property; ground rent, interest on loan taken for construction, purchase, repairs etc. of house; land revenue and property tax; collection charges; vacancy allowance and unrealised rent. After allowing all these deductions from adjusted annual value the resulting figure would be the taxable income from house property.

8.10 KEY WORDS

Annual Value : Annual value of a house property is reasonable rent or actual rent (if let out) whichever is higher as reduced by municipal taxes borne by the owner.

Composite Rent : When the building is let out along with certain facilities e.g. lift, electricity etc. then the rent includes the rent for the house and these facilities. Such a rent is called composite rent.

Ground Rent : Rent paid by the lessee on the land on which his building is erected.

Municipal Value : Value of the property fixed by local authorities on the basis of its income earning capacity.

Reasonable Rent : Rent of similar properties in the same locality.

self-occupied House : House occupied by the owner of the property for his residential purposes.

Standard Rent : Rent fixed by the Rent Controller under Rent Control Act.

Statutory Deduction : Deduction available to newly constructed houses for five years from the date of completion.

Unrealised Rent : Rent not recoverable by the owner;

8.11 ANSWERS TO CHECK YOUR PROGRESS

A 3 i) a ii) c iii) c iv) b

B 1 Rs. 8,800

3 Rs. 1,400

8.12 TERMINAL QUESTIONS/EXERCISES

Questions

- 1) Define annual value and state the deductions that are allowed from the annual value in computing the income from house property.
- 2) Write short notes :
 - a) Vacancy Allowance
 - b) Unrealised Rent
 - c) Repair Allowance
 - d) Income from House Property in foreign country
 - e) Standard Rent.
- 3) How would you determine the annual value of house property, which is self-occupied for a part of the year only and let out for the remaining part.

Exercises

- 1) Mr. X owns house property. Its annual letting value is Rs. 8,000. During the previous year it was let out to a tenant on monthly rent of Rs. 600. He claimed the following expenses actually incurred by him:
 - i) Municipal taxes Rs. 800.
 - ii) Expenses for the recovery of rent Rs. 600.
 - iii) Maintenance allowance paid to the step-mother Rs. 1,000 annually which was a charge on the property according to his father's will.

The house remained vacant for one month during the previous year. Find out the income from house property for the assessment year 1990-91.

(Answer : Rs. 3,968)

- 2) Mr. A owns a house which is let out for residential purposes. The construction of the house was completed in June 1986. The annual letting value of the house is Rs. 8,400. Municipal taxes paid Rs. 1,200. He spent Rs. 200 on repairs. On 1.4.1984 he had borrowed Rs. 30,000 on pro-note at 12% interest and spent it on the construction of the house. Nothing has been repaid out of this loan so far. Mr. A earns salary of Rs. 2,400 p.m. He has a scooter for going to office and spends for petrol etc. on an average Rs. 100 per month. Compute his income from house property and also his total income for the assessment year 1990-91. (Answer : Property Loss Rs. 2,040; Net Salary Rs. 19,200; Total Income Rs. 17,160.)
- 3) An assessee owns three house properties of which he used one (No. III) for his residence. The following are the particulars in respect of the properties for the year ended 31st March, 1990:

	I	II	III
When constructed	1953	March 1985	1968
	Rs.	Rs.	Rs.
Standard Rent	13,000	5,000	—

Other Heads of Income

Municipal Value	12,000,	4,000	10,000
Rent Received	14,000	4,800	—
Municipal Tax Paid	1,500	500	500
How used	Let out for business	Let out for residence	Self-occupied
Repairs	600	200	—
Interest on mortgage (Loan not taken for house property)	—	500	—
Ground Rent	50	30	—
Fire Insurance Premium	70	—	—
Vacancy	3 months	—	—
Collection charges	850	50	—

The assessee's total income from other sources is Rs. 20,000. Compute the total income of the assessee.

(Answer : Property I Rs. 6,422; Property II Rs. 670; Property III Nil; Total Income Rs. 23,092 or Rs. 27,090)

- 4) Mr. A has the following properties:
- 1) Flat in **Bombay** purchased on 1st June, 1989, which is let out on a monthly rent of Rs. 2,000. The building in which the flat is located was completed in May 1989. The flat was let out from 1st August, 1989.
 - 2) Flat in Delhi constructed in 1985 which is self-occupied.
 - 3) **Godown** in Calcutta constructed in 1985 which is let out on a monthly rent of Rs. 6,000.

The expenses actually incurred during the year against rental income are:

	At Bombay Rs.	At Delhi Rs.	At Calcutta Rs.
Municipal Taxes Paid	5,000	8,000	18,000
Building Co-operative Maintenance Charges	1,000	900	—
Electricity Charges	—	1,200	4,800
Fire Insurance Premium	—	—	600
Collection Charges	700	—	5,400
Repairs	20	1,900	11,000

The following further information is given:

- 1) The flat in Delhi is let out for **godown w.e.f. 1.1.1990** which fetches a monthly rent of Rs. 4,000.
- 2) Mr. A received a consolidated salary of Rs. 1,500 per month during the year from a part-time employment which he holds. Compute Mr. A's gross total income for the year ended on 31.3.1990.

(Answer : Bombay Flat Rs. 6,900; Calcutta Godown Rs. 41,160; Delhi Flat Rs. 8,333; Salary Rs. 12,000; Gross Total Income Rs. 68,393.)

- 5) Mr. P. owns a house at **Kanpur** (Municipal value Rs. 30,000) of the fair rent of Rs. 36,000 p.a. During the previous year 1989-90 the house is let out for residential purposes on a monthly rent of Rs. 4,000 from 1st April 1989 to 30th June 1989 and self-occupied for residential purposes for the remaining part of the year 1989-90. Municipal taxes Rs. 6,000, Fire Insurance Premium Rs. 3,000, Land Revenue Rs. 3,000 and Collection Charges Rs. 600 were paid during the year. A loan of Rs. 50,000 was taken on 1st April 1986 @ 10% p.a. for the construction of the house which was completed on 1st January '89. Rs. 10,000 was paid towards the loan account on 1st April 1988. Find out his taxable income from house property for the Assessment Year 1990-91. **(Answer : Taxable Income from House Property Nil)**

- 6) Assume in Exercise 5 that:

a) two-third portion of the house is self-occupied. and

b) One-third portion of the house is let out for residential purposes from 1st April 1989 to 30th November 1989 on a rent of Rs. 1,500 p.m. and from 1st December 1989 it was again self-occupied.

Find out his taxable income from house property for the Assessment Year 1990-91.

(Answer : Taxable Income from House Property Nil)

Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 9 CAPITAL GAINS

Structure

- 9.0 Objectives
- 9.1 Introduction
- 9.2 Meaning of Capital Gains
 - 9.2.1 Concept of Capital Asset
 - 9.2.2 Transfer of Capital Asset
- 9.3 Computation of Capital Gains
- 9.4 Capital Gains Exempt from Tax
- 9.5 Deductions Allowed from long-term Capital Gains
- 9.6 Computation of Taxable Income from Capital Gains
- 9.7 Let Us Sum Up
- 9.8 Key Words
- 9.9 Answers to Check Your Progress
- 9.10 Terminal Questions/Exercises

9.0 OBJECTIVES

After studying this unit, you should be able to :

- explain the meaning of the term capital gains;
- list the capital gains exempt from tax;
- discuss the deductions allowed from long-term capital gains;
- compute the income chargeable under the head capital gains.

9.1 INTRODUCTION

You know 'capital gains' is a separate head of income and any income arising out of sale or transfer of a capital asset is charged to tax under this head. In this unit, you will study the meaning of capital gains, items included in capital gains capital gains exempt from tax and the deductions allowed from capital gains. You will also study how the taxable income from capital gains is calculated.

9.2 MEANING OF CAPITAL GAINS

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 above definition can be split up into three parts:

- (a) Capital Asset
- (b) Transfer of Capital Asset
- (c) Profits or Gains

Let us now discuss each one of them in detail:

9.2.1 Concept of Capital Asset

Capital asset means property of any kind held by an assessee whether or not connected with his business or profession. The asset may be movable, immovable, tangible or intangible. But the term capital asset does not include:

- i) any stock-in-trade, consumable stores or raw materials held for the purposes of his business or profession;
- ii) personal effects, that is to say, movable property (including wearing apparel and furniture but excluding jewellery) held for personal use by the assessee or any member of his family dependent on him;

- iii) agricultural land in India (situated in rural areas) not being land situated within the limits of any municipality or a cantonment board having a population of 10,000 or more or situated in areas lying within a distance not exceeding 8 kilometres from the local limits of such municipalities or cantonment boards (i.e., agricultural land situated within municipal or cantonment board limits or within a distance of eight kilometres from the local limits of a municipality or cantonment board is included in the term 'Capital Asset' and it is only the agricultural land which is situated outside such limits that is excluded from the term 'Capital Asset').
- iv) 6½% Gold Bonds, 1977 or 7% Gold Bonds, 1980 or National Defence Gold Bonds, 1980, issued by the Central Government.
- v) Special Bearer Bonds, 1991.

Note : Capital assets include leasehold rights, a partner's right to share in the profits of a firm and manufacturing license. For the purposes of clause (ii) jewellery includes:

- a) Ornaments made of gold, silver, platinum or any other precious metal, whether or not worked or sewn into any wearing apparel.
- b) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

Kinds of Capital Assets : Interestingly the classification of capital asset does not depend on their durability but the period for which they have been held. Capital assets are divided into two categories:

- (i) Short-term Capital Asset and (ii) Long-term Capital Asset.

Short-term Capital Asset : Short-term Capital Asset means a capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer. In the case of a share held in a company, short-term capital asset will mean a share held by the assessee for not more than 12 months instead of 36 months in case of other assets.

Long-term Capital Asset : Long-term Capital Asset means a capital asset (other than shares in a company) held by an assessee for more than 36 months immediately preceding the date of transfer. In the case of shares held in a company, long-term capital asset will mean shares held by the assessee for more than 12 months.

Short-term and Long-term Capital Gains : Capital gains arising from the transfer of short-term Capital Assets are called short-term Capital Gains.

Capital gains arising from the transfer of long-term Capital Assets are called Long-term Capital Gains.

9.2.2 Concept of Transfer

Transfer in relation to a capital asset includes (i) sale, exchange or relinquishment of the assets, or (ii) the extinguishment of any rights therein, or (iii) the compulsory acquisition by the Government under any law, or (iv) where the asset is converted by the owner thereof into stock-in-trade of a business carried on by him, such conversion. Further, where a business is converted into a limited company, there is a transfer of capital assets, or (v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in the Transfer of Property Act, 1882, or (vi) any transaction which has the effect of transferring or enabling the enjoyment of any immovable property.

Transactions not regarded as transfer

The following transactions are generally not regarded as transfer for the purpose of capital gains

- i) Any distribution of capital assets on the total or partial partition of a Hindu undivided family.
- ii) Any transfer of a capital asset under a gift or will or an irrevocable trust.
- iii) Any transfer of a capital asset by a company to its subsidiary company, if—

- a) the parent company holds the whole of the share capital of the subsidiary company, and
- b) the subsidiary company is an Indian Company.
- iv) Any transfer of a capital asset by a subsidiary company to the holding company, if—
 - a) the whole of the share capital of the subsidiary company is held by the holding company, and
 - b) the holding company is an Indian Company. Any transfer of a capital asset as per clause (iii) or (iv) above shall be treated as transfer if the transfer is made after 29th February, 1968, as Stock-in-trade.
- v) Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian Company.
- vi) Any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if—
 - a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
 - b) the amalgamated company is an Indian Company.
- vii) Any transfer of agricultural land in India effected before 1st March, 1970.
- viii) Any transfer of a capital asset, being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, photograph or print, to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government in Official Gazette to be of national importance or to be of renown throughout any State or States.

Exceptions : If at any time before the expiry of eight years from the date of transfer of a capital asset referred to in clauses (iii) and (iv) above, such capital asset is converted by the transferee company into stock-in-trade of its business or the holding company ceases to hold the whole of the share capital of the subsidiary company before the expiry of the period of eight years from the date of transfer, the amount of capital gain exempted from tax u/s 47 shall be deemed to be the income of transferor company chargeable under the head 'Capital Gains' of the year in which such transfer took place.

9.3 COMPUTATION OF CAPITAL GAINS

The income chargeable under the head 'Capital Gains' shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts:

- a) expenditure incurred wholly and exclusively in connection with such transfer, and
- b) the cost of acquisition of the capital asset and cost of any improvement thereof.

This may be explained in the form of equation as under:

$$\text{Capital Gain} = \text{Full value of consideration} - (\text{Cost of acquisition} + \text{Cost of improvement} + \text{Selling Expenses})$$

9.4 CAPITAL GAINS EXEMPT FROM TAX

As discussed earlier any profits or gains arising from transfer of any capital asset is chargeable under the head capital gains. But any profits or gains arising out of transfer of certain capital assets are exempt from tax i.e., such profits or gains are not included in the taxable income of the assessee.

The capital gains exempt from tax are :

- i) Capital gains arising out of the transactions not regarded as transfer u/s 47.

- ii) Capital gains arising from the transfer of a residential house subject to the conditions laid down u/s 53.
- iii) Capital gains arising on the transfer of property used for residence and the land appurtenant thereto subject to the conditions laid down u/s 54.
- iv) Capital gains arising from the transfer of agricultural land situated in an urban area are exempt subject to the provisions contained in Section 54B.
- v) Any capital gains arising out of compulsory acquisition of land and buildings are exempt from tax subject to the provisions of Section 54D.
- vi) Subject to the conditions of Section 54E, the capital gains arising on transfer of a long-term capital asset are exempt from tax.
- vii) Any long-term capital gains arising on investment in residential houses is exempt subject to conditions laid down in Section 54F.
- viii) Capital gains on shifting of industrial undertaking from urban area are exempt from tax subject to the conditions laid down in Section 54G.

Note : For the purposes of exemption u/s 53, 54, 54B, 54D, 54E, 54F and 54G capital gain shall be computed as under

Full value of consideration – (Cost of acquisition + Cost of improvement + expenditure incurred in connection with transfer)

Item number ii), iii), iv) and vi) being more important are explained in detail.

- ii) Capital Gains arising from the transfer of a residential house (Sec. 53) Under this section if the following conditions are satisfied the capital gain shall be exempt from tax:
 - a) The building is owned by an Individual or Hindu Undivided Family
 - b) The building is used for residential purposes (self-occupied or let out) and its income is chargeable under the head Income from House Property.
 - c) The building has been held by the assessee for more than 36 months before its transfer.
 - d) The assessee does not own any other residential house on the date of such transfer.
 - e) If the consideration received or accruing as a result of the transfer does not exceed Rs. 2 lakhs, the whole amount of capital gain is exempt. If such consideration exceeds Rs. 2 lakhs, the capital gain would be exempted proportionately. In other words, the amount of capital gain to be exempted would bear the same proportion to the amount of the capital gain arising from the transfer as the amount of Rs. 2 lakhs bears to the amount of consideration received or accruing from the transfer.
- iii) Capital gains arising on the transfer of property used for residence (Sec. 54) : Any capital gain arising from the transfer of a house or land appurtenant thereto is exempt subject to the following conditions:
 - a) The building is owned by an individual or H.U.F.
 - b) Such property was being used as residential house.
 - c) The income of such property is chargeable under the head income from house property.
 - d) The exemption will be available only in relation to a house property which had been held by the tax-payer for a period exceeding 36 months before transfer.
 - e) The assessee has, within a period of one year before or two years' after the date of transfer purchased a residential house
 - he has within a period of three years after the date of transfer constructed a residential house.
 - f) The capital gains arising from the transfer of such residential house is exempt to the extent of the cost of the new residential house purchased or constructed within the specified period. It means that if, the whole capital gain is

re-invested in the cost of the new house it is fully exempt from tax. If only a part of it is re-invested, the balance of it is chargeable to tax.

- g) Where the amount of capital gain is not utilised by the assessee for acquisition of new house before the date of furnishing the return of income, it shall be deposited by him on or before the due date of furnishing the return of income u/s 139, in an account opened under the Capital Gains Accounts Scheme, 1988, with State Bank of India or any of its subsidiaries or with any nationalised bank authorised by the Central Government. The amount already utilised for re-investment together with the amount of deposits shall be deemed to be the cost of the new house. After such deposit he must utilise the deposit for acquiring the new house within 3 years.
- iv) Capital gain arising from the transfer of agricultural land (S. 54B) : Any capital gain arising on the transfer of agricultural land situated in an urban area is exempt subject to the following conditions :
- a) The agricultural land is owned by an individual.
 - b) The agricultural land was, in the two years immediately preceding the date of transfer, being used either by the assessee or his parent for agricultural purposes.
 - c) The assessee has purchased within a period of two years, from the date of transfer, any other land for being used for agricultural purposes.
 - d) The capital gain arising from the transfer of such agricultural land is exempt to the extent of the cost of the new agricultural land purchased within the specified period mentioned in (c) above. It means that if the whole capital gain is re-invested it is fully exempt from tax. If only a part of it is re-invested the balance of it is chargeable to tax.
 - e) If the amount of capital gain is not utilised by the assessee for acquisition of new agricultural land before the due date for furnishing the return of income,, it shall be deposited by him on or before the due date of furnishing the return of income in an account opened under the Capital Gains Account Scheme, 1988. The amount already utilised for re-investment together with the amount of deposits shall be deemed to be the cost of the new agricultural land. If the amount deposited is not fully utilised for acquiring the new agricultural land within two years, the amount not so utilised shall be treated as the long-term capital gain of the previous year in which the period of two years expires.
- v) Capital Gain on the transfer of long-term Capital Asset (Sec. 54E) : Any capital gain on the transfer of a long-term capital asset is exempt if the following conditions are satisfied :
- a) The assessee has transferred a long-term capital asset.
 - b) The net consideration (i.e. net sale proceeds) has been invested in specified new asset by initially subscribing to such new asset within six months from the date of transfer of the asset.
 - c) If a part of net consideration is invested, proportionate part of the capital gain will be exempt from tax.
 - d) If the assessee receives some money as earnest money or advance and invests in the specified assets before the date of transfer of asset, the amount so invested will qualify for exemption under section 54E.
 - e) Where the asset is transferred after 31.3.1989 the exemption will be available if the amount is invested in—
 - i) Securities of the Central Government specified by that government in this behalf;
 - ii) Special series of units of the Unit Trust of India specified by the Central Government in this behalf. Units issued under the Capital Gains Unit Scheme, 1983 have been notified for this purpose.
 - iii) Notified National Rural Development Bonds.
 - iv) Such debentures issued by the Housing and Urban Development Finance Corporation Limited, as the Central Government may specify in this behalf.

- v) Notified Bonds issued by any public sector company.
- vi) Notified debentures or bonds issued by the National Housing Bank.
- f) The assessee will be required to hold the new asset for a period of three years from the date of its acquisition. The exemption will be forfeited if the assessee transfers the assets with three years and the exempted capital gain will be taxed as long-term capital gain in the year in which the assets are transferred.

9.5 DEDUCTIONS ALLOWED FROM LONG-TERM CAPITAL GAINS

You know how the amount of capital gains is calculated. After this amount has been computed as explained in Section 9.3 certain deductions are to be made in order to calculate the taxable amount of capital gains. Before explaining the deductions we must remind you that gains are of two types short-term and long-term capital gains.

No deduction is allowed from short-term capital gains i.e., the total amount of short-term capital gains is taxable. As far as the long-term capital gains are concerned certain deductions are allowed u/s 48(2). The amount of deduction is calculated as follows:

- i) Where the amount of long-term capital gain, does not exceed Rs. 10,000 the whole of such amount shall be deducted, or
- ii) Where the amount of long-term capital gain exceeds Rs. 10,000 the following deductions shall be made.

Status of Assessee	Rates of deduction in respect of long-term capital gains relating to buildings or lands, gold bullion or jewellery	Rates of deduction in respect of long-term capital gains relating to other-Capital Assets	Rates of deduction in respect of long-term capital gains to equity shares of Venture Capital Undertakings
Non-company Assessee	Rs. 10,000 + 50% of the balance	Rs. 10,000 + 60% of the balance	Rs. 10,000 + 60% of the balance
Company Assessee	Rs. 10,000 + 10% of the balance	Rs. 10,000 + 30% of the balance	Rs. 10,000 + 30% of the balance

Provided that where the long-term capital gain relates to both categories of capital assets referred to above, the deduction of Rs. 10,000 shall first be allowed against the long-term capital gain relating to buildings or lands or gold or bullion or jewellery and thereafter the balance, if any, of the said Rs. 10,000 shall be allowed as deduction against long-term capital gain relating to other assets.

Explanation

- 1) Venture capital company means a company which is engaged in providing finance to Venture Capital Undertaking mainly by way of acquiring equity shares of such undertakings or by way of advancing loans to such undertakings.
- 2) A Venture Capital Undertaking means such company as the prescribed authority approves having regards to the following factors:
 - a) the total investment in the company does not exceed Rupees 10 Crores or such other higher amount as may be prescribed.
 - b) The company does not have adequate financial resources to undertake projects for which it is otherwise professionally or technically equipped; and
 - c) the company seeks to employ any technology which will result in significant improvement over the existing technology in India in any field and the investment in such technology involves high risk.

Deductions if there are Long-term Capital Losses (Section 48(3))

Long-term capital losses will also be scaled down as per the above deductions (i.e., these deductions will be made from long-term capital losses also in the same manner

as from long-term capital gains) and the balance amount shall be net long-term capital loss to be set-off against any other capital gain or income under any other head. The net unabsorbed long-term capital losses will be allowed to be carried forward for 8 years as business losses to be set-off against capital gains only.

9.6 COMPUTATION OF TAXABLE INCOME FROM CAPITAL GAINS

After the amount of capital gains is calculated and the deduction u/s 48(2) allowed the amount left is the income chargeable to tax under the head income from capital gains.

Let us now look at few illustrations to clearly understand the computation of income from capital gains.

Illustration 1

From the information given below compute the amount of capital gain that should be included under the head capital gains :

	Rs.
1) Purchased agricultural land in 1976	1,50,000
2) Sold the land on 1.9.1989	2,50,000
3) Purchased another agricultural land on 1.10.89	50,000

Solution

	Rs.
Selling price of the agricultural land	2,50,000
Less : Cost of acquisition of the land	<u>1,50,000</u>
Long-term capital gain.....	1,00,000
Less : Cost of the new land purchased before the due date for furnishing the return of income (Exempt u/s 54).....	<u>50,000"</u>
	50,000
Less : Deduction u/s 48(2): (Rs. 10,000 + 50% of Rs. 40,000)	<u>30,000</u>
Capital gain for inclusion in income under the head capital gains	<u><u>20,000</u></u>

Illustration 2

During the year ending 31st March 1990, Mr. X sold the following assets:

	Sale Proceeds Rs.
1) House (non-residential) purchased for Rs. 28,000 in January 1974 sold on 28.2.1990	50,000
2) Machinery purchased for Rs. 50,000 in December 1982 (written down value on 1.4.1989 being Rs. 35,000) sold in January 1990	60,000
3) Office furniture purchased for Rs. 1,000 on 1.5.87 (W.D.V. on 1.4.89 Rs. 800) sold on 15th December 1989	1,300
4) Land situated in Agra purchased for Rs. 10,000 in December 1984 sold in January 1990	24,000
5) Residential house purchased 5 years back for Rs. 50,000 sold on 15th February 1990	90,000

During the year before the due date for filing the return of income he bought another house for the residential purposes for Rs. 40,000. Work out the amount of capital gain to be included in his total income.

Solution

computation of Capital Gains

Long-term Capital Gains :	Rs.	Rs.
Non-residential house	22,000	
Residential house exempt u/s 53	Nil	
Land	<u>14,000</u>	
Less deduction allowed u/s 48(2)	36,000	
Initial Deduction	10,000	
50% of Rs. 26,000	<u>13,000</u>	<u>23,000</u>
		13,000
Short-term Capital Gains :		
Furniture		
Sale proceeds	1,300	
Less W.D.V. on 1.4.89	<u>800</u>	500
Machinery :		
Sales proceeds	60,000	
Less W.D.V. on 1.4.89	<u>35,000</u>	<u>25,500</u>
	25,000	<u>25,500</u>
	Taxable Capital Gains	<u>Rs. 38,500</u>

Note : The capital gain on the sale of residential house is exempt u/s 53 as the assessee does not own any other residential house on the date of sale and the sale proceeds do not exceed Rs. 2 lakhs.

Illustration 3

A sells his only residential house in Delhi on 31st October 1989 for Rs. 16,00,000 and incurs an expenditure of Rs. 40,000 in connection with the transfer. Cost of acquisition of the house by him in 1976 is Rs. 2,10,000. On 28th February 1990 he invests Rs. 5,20,000 in the Capital Gains Units of the U.T.I. On 15th March 1990 he purchases a residential house in Delhi for Rs. 4,00,000 and deposits Rs. 1,50,000 in the Capital Gains Account Scheme. Compute the taxable Capital Gain.

Solution

	Rs.
Full value of the consideration	16,00,000
Less Expenses incurred on transfer	<u>40,000</u>
	Net Consideration 15,60,000
Less Cost of acquisition	<u>2,10,000</u>
	Capital Gain 13,50,000
Less Exemption u/s 53 for sale of residential house = $\frac{13,50,000 \times 2,00,000}{15,60,000} =$	<u>1,73,077</u>
	11,76,923
Less Exemption u/s 54 (Rs. 4,00,000 Cost of house + Rs. 1,50,000 Deposit in C.G.A/c)	<u>5,50,000</u>
	6,26,923
Less Exemption u/s 54E (general) = $\frac{13,50,000 \times 5,20,000}{15,60,000} =$	<u>4,50,000</u>
	Chargeable C.G. 1,76,923
Less Deduction u/s 48(2):	
Initial Deduction	10,000
50% of the balance of Rs. 1,66,923	<u>83,461</u>
	<u>93,461</u>
	Taxable Capital Gain.....Rs. <u>83,462</u>

Illustration 4

Mr. R sells shares of a company on 31st July 1989 for Rs. 9,00,000, incurring an expenditure of Rs. 50,000 in connection with transfer. The cost of acquisition of

Other Heads of Income

shares on 15th December 1987 was Rs. 2,50,000. On 15th November 1989 he purchased the National Rural Development Bonds for Rs. 2,50,000 and capital gains units of U.T.I. for Rs. 90,000. Compute the amount of taxable capital gains.

	Rs.
Solution	
Full value of consideration	9,00,000
Less Expenses on Transfer	50,000
	8,50,000
Net Consideration	
Less Cost of acquisition	2,50,000
Capital Gain being long-term as it was held for more than 12 months before transfer	6,00,000
Less Exemption u/s 54E $\left(\frac{6,00,000 \times 3,40,000}{8,50,000}\right)$	2,40,000
	3,60,000
Chargeable Capital Gain	3,60,000
Less Deduction u/s 48(2). Initial Rs 10,000 + 50% of balance of Rs. 3.50,000 = Rs. 1,85,000	1,85,000
Taxable Capital Gain Rs.	1,75,000

Check Your Progress A

- 1) Read the following and tick mark the correct answer in each of the following:
 - i) On 31.3.90 'D' earns a profit of Rs. 50,000 by selling a piece of land in Lucknow on which vegetables were being grown and which was purchased on 30.12.1981. In his Income-tax Assessment for 1990-91 the profit would be taxable as:
 - a) Short-term capital gain;
 - b) Long-term capital gain;
 - c) Not taxable, being profit on sale of agricultural land.
 - ii) An individual invested Rs. 1 lakh in a partnership business in 1975. On retirement from the firm on 31.3.1990 he was paid Rs. 3 lakhs in full and final settlement. For 1990-91 capital gains to be included in his income-tax assessment are:
 - a) Rs. 2 lakhs;
 - b) Rs. 97,500;
 - c) Rs. Nil.
 - iii) 'A' purchased a motor-car for his personal use on 10.1.1987 for Rs. 20,000. He spent Rs. 5,000 on fittings, accessories etc. and sold it for Rs. 35,000 on 31.3.1990. The capital gains from the sale of the car to be included in total income for the assessment year 1990-91 would be:
 - a) Rs. 10,000;
 - b) Rs. 5,000;
 - c) Nil
 - iv) Mr. X sold a house used for his residence since 1969 in July 1983. On this sale he earned a capital gain of Rs. 60,000. He constructed another house for his residence for Rs. 60,000 in June 1986. The latter house was sold in December 1989 for Rs. 90,000. Capital gains assessable in his hands for assessment year 1990-91 will be:
 - a) Rs. 30,000;
 - b) Rs. 60,000;
 - c) Rs. 90,000.
 - v) In accounting year 1989-90, A sells all the three houses belonging to him for Rs. 9,000, Rs. 10,000 and Rs. 15,000, which were purchased in 1983 for Rs. 5,000, Rs. 6,000 and Rs. 8,000 respectively. For inclusion in his total income for the assessment year 1990-91 long-term capital gains would be:
 - a) Rs. 15,000;
 - b) Rs. 11,500;
 - c) Nil
 - d) Rs. 2,500.

vi) **Assessee 'A'** purchased a residential house on 1.5.1984 for Rs. 50,000 and started living in it. On 1.8.1989 he sold this house for Rs. 80,000. He constructed another residential house for self-occupation at a total cost of Rs. 70,000 in December 1989. Capital gains to be included in his assessment for assessment year 1990-91 are:

- a) Rs. 10,000;
- b) Rs. 15,000;
- c) Rs. 14,400;
- d) Nil

2) Fill up the blanks in the following:

- i) Any distribution of capital assets on the partition of a Hindu Undivided Family is.....as transfer.
- ii) Long-term Capital **Asset** means a capital asset held for more than..... months.
- iii) Under section 48(2), a deduction of.....is admissible regarding long-term capital gains in respect of land and buildings in the case of a **non**-corporate assessee.
- iv) Long-term capital losses are scaled down.....as deduction is admissible from long-term capital gains.
- v) Unabsorbed long-term capital losses are allowed to be carried forward for.....years.

9.7 LET US SUM UP

Any profits or gains arising from the transfer of a capital **asset** affected in the previous year shall be chargeable to income-tax under the head 'Capital Gains'. Capital asset means property of any kind held by an **assessee** whether or not connected with his business' or profession, but does not include stock-in-trade, personal effects and, agricultural land in India. Capital assets are of two types —long-term and short-term. Long-term capital assets are those which are held by the **assessee** for more than 36 months before transfer and short-capital assets are those which are held by the **assessee** for not more than 36 months before transfer.

Capital gains arising **from** the transfer of short-term capital assets are called short-term capital gains and capital gains **arising** from the transfer of long-term capital assets are called long-term capital gains.

Transfer of a capital asset means sale, exchange or extinguishment of any rights therein, or its compulsory acquisition under any law or its conversion into stock-in-trade etc.

The income chargeable under the head 'Capital Gains' **shall** be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital assets: (i) **expenditure** incurred wholly and exclusively in connection with the transfer, and (ii) the cost of acquisition of the capital asset and cost of any improvement thereto.

Only long-term capital gains are exempt from tax under Section 53, 54, 54E, and 54F, subject to the fulfilment of certain conditions. Similarly, capital gains are also exempt under sections 54B, 54D and 54G subject to fulfilment of certain conditions.

In the case of long-term capital gains an initial deduction of Rs. 10,000 is made and thereafter on the balance of such capital gain deduction at specified percentage will be allowed on specified nature of capital gains. The net balance left thereafter shall be taxable capital gain.

In case of long-term capital losses also deduction **shall be** made in the same manner as is done in respect of long-term capital gains **u/s 48(2)** and the balance of the amount **shall** be net long-term capital loss to be set-off **and/or** carry forward.

9.8 KEY WORDS

Capital Asset : Capital asset means property of any kind held by an assessee, whether or not connected with his business or profession except stock-in-trade, personal effects and agricultural land in India.

Capital Gains : Profits or gains arising from the transfer of a capital asset is called capital gain.

Long-term capital gain : Capital gain arising from the transfer of an asset held for more than 36 months (in case of shares for more than 12 months) is called long-term capital gain.

Short-term capital gain : Capital gain arising from the transfer of an asset held for not more than 36 months (in case of shares for not more than 12 months) is called short-term capital gain.

Transfer : Transfer in relation to a capital asset includes the sale, exchange or relinquishment of an asset, the extinguishment of any rights therein, or compulsory acquisition thereof under any law or conversion of an asset into stock-in-trade.

9.9 ANSWERS TO CHECK YOUR PROGRESS

A 1) i) **b**; ii) c; iii) c (Personal effect); iv) **a**; v) d; vi) d.

2) i) not regarded

ii) 36

iii) Rs. 10,000 + 50% of the balance

iv) in the same manner

v) eight

9.10 TERMINAL QUESTIONS AND EXERCISES

Questions

- 1) What does the term 'Capital Gains' signify under the Income Tax Act?
- 2) Explain the following terms in the context of the I.T. Act.
 - i) Capital Assets;
 - ii) Short-term Capital Assets
 - iii) Transfer of Capital Assets
- 3) Discuss the provisions of the Income-tax Act regarding exemption of capital gains u/s 54E?

Exercises

- 1) Mr. X had two houses. The first house was occupied by himself for residence: He got this house from his uncle as a gift on 15th July, 1984. His uncle purchased this house in 1972 for Rs. 56,000. Its fair market value on April 1, 1974, was Rs. 70,000 and on January 1, 1981, it was Rs. 1,10,000. Mr X spent Rs. 5,000 on its improvement and sold it on 30th November, 1989 for Rs. 2,00,000. He purchased another house for his residence on 25th February, 1990 for Rs. 1,00,000.

He had purchased the second house for Rs. 50,000 in 1975 and had let out for residential purpose. He sold this house on 15th June, 1989, for Rs. 90,000 and purchased another residential house on 18th March, 1990, for Rs. 60,000.

He had purchased some jewellery in 1976 for Rs. 70,000. On 22nd February, 1990, he sold this jewellery for Rs. 1,50,000 and purchased on 15th March, 1990, notified National Rural Development Bonds of Rs. 75,000.

You have to determine the taxable capital gains of Mr. X for Assessment Year 1990-91. (Answer : Rs. 15,000) .-

- 2) Mr. A provides the following data regarding his transaction for the sale of his residential house for assessment year 1990-91. Compute the amount of Net Capital Gain to be included in his Total Income for the Assessment Year; 1990-91:

	Rs.
House purchased in 1977	4,50,000
Sold in November 1989	7,50,000
Purchased another house in September 1989	1,50,000
Invested in Notified Government Securities in January, 1990	3,00,000
(Answer : Rs. 10,000)	

- 3) Mr. X sold his residential house for Rs. 20,00,000 on 10th June, 1989. This house was constructed in 1976 at a cost of Rs. 5,00,000. Mr. X did not own any other house on the date of this transfer. For securing exemption in respect of long-term capital gains, he made the following investments:

- 1) He purchased National Rural Development Bonds on 5th July, 1989 for Rs. 1,00,000.
- 2) He purchased a residential house on 1st December 1989 for Rs. 2,00,000.
- 3) He deposited Rs. 10,00,000 on 30th November 1989, in Capital Gains Account Scheme, 1988. This amount was deposited for purchasing or constructing a house. Compute the amount of taxable capital gains for the Assessment Year 1990-91.

(Answer : Exemption u/s 53 : Rs. 1,50,000; u/s 54 Rs. 12,00,000; and u/s 54E Rs. 75,000. Taxable Capital Gain Rs. 32,500.)

- 4) Mr P sold the following assets during the financial year 1989-90:

- i) Sold a self residential house for Rs. 3,00,000; Rs. 20,000 were spent in connection with this sale. The house was purchased for Rs. 1,00,000 ten years back and Rs. 20,000 were spent on its renewal.
- ii) Sold gold ornaments for Rs. 1,50,000. These ornaments were made in 1972 at a cost of Rs. 50,000 and their fair market value on 1st April, 1974, was Rs. 70,000.
- iii) Sold an agricultural land situated in a village for Rs 80,000. The land was bought in 1976 for Rs. 50,000.
- iv) On 1st February 1990 he sold 1,000 shares in a company @ Rs. 250 per share. Half of these shares were purchased by him on 1st December 1988 @ Rs. 150 per share and half were purchased on 15th March, 1989 @ Rs. 120 per share.

Answer : STCG Rs. 65,000; LTCG Reg : House Rs. 1,60,000; Reg : Gold Ornaments Rs. 80,000; Reg : Shares Rs. 50,000 = Total LTCG Rs. 2,90,000; Deduction u/s 48(2) on House Rs. 10,000 + 75,000; On Gold Ornaments Rs. 40,000 and on Shares Rs. 30,000. Total Deduction Rs. 1,40,000. Taxable LTCG Rs. 1,50,000. Total Taxable Capital Gains LTCG+STCG=Rs. 2,15,000.

Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 10 INCOME FROM OTHER SOURCES

Structure

- 10.0 Objectives
- 10.1 Introduction
- 10.2 Income Chargeable Under the Head
'Income from Other Sources'
- 10.3 Deductions Allowed
- 10.4 Dividends
 - 10.4.1 Rules for Taxation of Dividends
 - 10.4.2 Grossing up of Dividends
- 10.5 Winnings from Lotteries, Crossword Puzzles, Horse Races, Card Games, etc.
- 10.6 Interest on Securities
 - 10.6.1 Basis of Charge
 - 10.6.2 Kinds of Securities
 - 10.6.3 Grossing up of Interest on Securities
 - 10.6.4 Bondwashing Transactions
 - 10.6.5 Interest on Securities Exempt from Tax
- 10.7 Set-Off and Carry forward of Losses
 - 10.7.1 Inter-source Adjustment
 - 10.7.2 Inter-head Adjustment
 - 10.7.3 Set-off of Capital Losses
 - 10.7.4 Carry Forward and Set-Off of Capital Losses
- 10.8 Let Us Sum Up
- 10.9 Key Words
- 10.10 Answers to Check Your Progress
- 10.11 Terminal Questions/Exercises

10.0 OBJECTIVES

After studying this 'Unit you should be able to:

- list the incomes falling under the head 'Income from other sources';
- explain in detail the provisions of income tax for dividends and interest on securities;
- discuss the set off and carry forward of losses

10.1 INTRODUCTION

You have read about three heads of income. Income specific to a particular head is included in and charged to tax under that head. Income from other sources is a head of income which includes all those incomes which are:

- i) listed in the definition of income,
- ii) not exempt from tax, and
- iii) not included in any specific head i.e., salaries, house property, capital gains etc.
- iv) This means it is a **residuary** head which includes all those incomes which are not **included** in a specific head. In this unit you will study in detail the incomes included under this head and the provisions of income tax relating to them. You will also study about the set-off and carry forward of losses.

10.2 INCOME CHARGEABLE UNDER THE HEAD 'INCOME FROM OTHER SOURCES'

Section 56(1) of the act states that, every kind of income which is included in the total income under the Income-tax Act, and which is not chargeable to income tax

under any other head of income, is chargeable to income tax under the head 'Income from Other Sources'.

Under Section 56(2), the following incomes shall be chargeable under the head 'Other Sources':

- 1) Dividends;
- 2) Income from winnings from lotteries, crossword puzzles, races including horse races, card games or any other games, gambling or betting etc.
- 3) Any sum received by the assessee from his employees as contribution to any provident fund or superannuation fund or any fund set up under Employees' Insurance Act 1948 or any other fund for the welfare of the employees provided it is not chargeable under the head "Profits and Gains of Business or Profession".
- 4) Income by way of interest on Securities if not chargeable under "Profits and Gains of Business or Profession".
- 5) Income from machinery, plant or furniture belonging to the assessee and let on hire if the income is not chargeable to income tax under the head 'Business or Profession'.
- 6) Where an-assessee lets on hire machinery, plant or furniture belonging to him and also buildings, and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if not chargeable to income tax under the head 'business' is chargeable under the head 'Other Sources'.

Besides the above, there are some other incomes also which are chargeable under the head 'Income from Other Sources.' They are:

- i) Any fees or commission received by an employee from a person other than his employer.
- ii) Any annuity received under a will. It does not include an annuity received by an employee from his employer.
- iii) All interest other than interest on securities.
- iv) Income of a tenant from sub-letting the whole or a part of the house property.
- v) Remuneration received by a non-professional for doing examination work, viz., a professor getting such remuneration.
- vi) Income of Royalty.
- vii) Director's fees.
- viii) Rent of land not appurtenant to any building.
- ix) Agricultural Income from land situated outside India.
- x) Income from markets, ferries and fisheries, etc.
- xi) Income from leasehold property.
- xii) Income of other persons included in the total income of the assessee, e.g., if the assessee and his spouse are partners in the same firm, the share of income' of the spouse is included in the total income of the assessee under the head 'Income from Other Sources'.
- xiii) Income received by non-professionals in consideration of writing articles in Journals.
- xiv) Interest received on foreign securities.
- xv) Income from undisclosed sources.
- xvi) Interest received by an employee on his own contributions to an unrecognized provident fund.
- xvii) Casual income in excess of Rs. 5,000.
- xviii) Salary of Member of Parliament, Member of Legislative Assembly or Council.
- xix) Interest received on securities of a co-operative society.
- xx) Family pension received by the widow and heirs of deceased employees.
- xxi) Income received from units of Unit Trust of India.

- xxii) Amount withdrawn from deposit in National Savings Scheme on which deduction u/s 80CCA has been allowed including interest thereon.

10.3 DEDUCTIONS ALLOWED

Under Section 57, the income chargeable under the head 'Income from Other Sources' shall be computed after making the following deductions :

- 1) In the case of dividends or interest on securities, any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such dividend or interest on behalf of the assessee, is deductible. No such deduction is allowed in case of a foreign company.
- 2) Where employees' contribution to Provident Fund, etc., are treated as the income of the assessee (employer) it is included in his income from other sources and a deduction of the sum, credited by the assessee to the employee's account in the relevant fund on or before the due date, will be allowed under this head.
- 3) In the case of income from letting of machinery, plant or furniture along with letting of buildings, which is chargeable to tax under the head 'income from other sources', the deductions in respect of the following shall be allowed:
 - i) Expenditure incurred regarding current repairs of machinery, plant, furniture or building.
 - ii) Insurance premium paid regarding building, machinery, plant or furniture against risk of damage or destruction of the assets.
 - iii) Depreciation on buildings, machinery, plant or furniture.
- 4) In the case of income in the nature of family pension received by the widows or heirs of deceased employee, a deduction of sum equal to 33 $\frac{1}{3}$ % of such income or Rs. 12,000, whichever is less, will be allowed.
- 5) Any other revenue expenditure incurred wholly and exclusively for the purpose of earning such income. It should not be in the nature of personal expenses of the assessee. No such deduction is allowed in case of a foreign company.

10.4 DIVIDENDS

In ordinary language dividend means the sum received by a shareholder of a company on the distribution of its profits; but under Section 2(22) dividend includes the following:

- a) Any distribution by a company of accumulated profits if such distribution entails the release by the company to its shareholders of all or any of the assets of the company.
- b) Any distribution to its shareholders by a company of debentures or deposit certificates in any form, and any distribution to its preference shareholders of shares by way of bonus, to the extent to which the company possesses accumulated profits.
- c) Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation.
- d) Any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits.
- e) Any payment by a company, not being a company, in which the public are substantially interested, of any sum by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest, to the extent to which the company possesses accumulated profits except where the advance or loan is made

to a shareholder or the said concern by a company in the ordinary course of its business, where the lending of money is substantial part of the business of the company.

Dividend does not Include the Following

- i) A distribution made in accordance with the above Clause (c) or Clause (d) in respect of any shares issued for full cash consideration, where the holder of shares is not entitled in the event of liquidation to participate in the surplus assets.
- ii) A distribution made in accordance with Clause (c) or Clause (d) in so far as such distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders after March 31, 1964 and before April 1, 1965.
- iii) Where the company goes into liquidation consequent of the compulsory acquisition of its undertaking by the Government or any Corporation owned or controlled by Government the distribution made by the liquidator of the company to its shareholders will not be charged to tax as 'dividend' to the extent such distribution is attributable to the accumulated profits of the company relating to any period prior to the three successive previous years immediately preceding the previous year in which the undertaking of the company is acquired.
- iv) Any advance or loan made to a shareholder of the said concern by the company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.
- v) Any dividend paid by a company which is set-off by the company against the whole or any part of the sum previously paid by it as advance or loan referred to above in Clause (e).
- vi) Where a company transfers its assets to another company in a scheme of amalgamation, such transfer is not regarded as a 'distribution' by the company of its accumulated profits to its shareholders even though its accumulated profits are embedded in the assets so transferred.

10.4.1 Rules for Taxation of Dividends

The following are the rules for taxations of dividends:

- i) Any dividends declared by a company shall be deemed to be the income of the shareholders of the previous year in which it is declared.
- ii) Any interim dividend shall be deemed to be the income of the shareholders of the previous year in which the amount of such dividend is unconditionally made available by the company to the members who are entitled to it, It means that the date of declaration of such dividends is immaterial so long as the amount is not released for disbursement.
- iii) Dividend paid by an Indian Company outside India shall be deemed to accrue or arise in India.
- iv) The entire amount of dividend received by a shareholder is taxable in his hands, even if the company had distributed this dividend out of non-taxable income, e.g., 60% of the income of a tea company is treated as agricultural income which is not taxable but the entire amount of dividend received by the shareholder of this company will be taxable in his hands with few exceptions.
- v) In the case of dividend received from a foreign company if the foreign company has deducted tax at source and nothing is paid out of it to the Government of India, the amount deducted as tax at source shall not be included in the dividend income of the Indian shareholder.
- vi) The income tax deducted at source from the dividend declared for the shareholders is to be included in the dividend income of the shareholders and as such the net amount of dividend received by a shareholder has to be grossed up or increased by the amount of tax deducted at source, and the shareholder gets credit in his assessment for the amount of tax deducted at source from the dividends declared by the company.

10.4.2 Grossing up of Dividends

Dividends may be tax-free or less tax. Tax-free dividends are those dividends for which the company does not deduct income tax at source. The total amount of

dividend declared is paid to the shareholders. The income tax though not deducted is paid by the company to the income tax department on behalf of the shareholders such income tax is actually the income of the shareholder so while calculating of income from dividends the tax-free dividends are to be grossed up.

Similarly less tax dividends are to be grossed up because in this case the income tax is deducted at source by the company and the net amount is paid to the shareholder. But the income from dividends earned by the shareholder is not the net dividend but the gross dividend before income tax is deducted therefrom, for the year 1989-90 the rate of deduction of tax at source for less tax dividends is 21.6%. In order to gross up less tax dividends, the net amount of dividend received should be multiplied by $\frac{100}{78.4}$. However, dividends shall be paid without deduction of tax at source in the

following cases if —

- i) It is paid to the non-company resident shareholders, who furnishes to the company (which pays dividend) a certificate from Assessing Officer that to the best of his belief the total income of the shareholder will be less than the minimum exempted limit of income-tax.
- ii) It is paid by a widely-held company to an individual who is resident in India if
 - a) the dividend is paid by an account payee cheque; and
 - b) the amount of such dividend during the financial year does not exceed Rs. 2,5001-.

10.5. WINNINGS FROM LOTTERIES, CROSSWORD PUZZLES, HORSE RACES, CARD GAMES, ETC.

Income from winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form of nature whatsoever, is taxable under head 'Income from Other Sources'. No deduction in respect of expenditure or allowance in connection with income by way of winnings from lotteries, cross word puzzles, horse races, card games etc. shall be allowed in computing the said income.

However, the person responsible for paying to any person any income by way of winnings from any lottery or crossword puzzles or horse race, of an amount exceeding Rs. 5,000 shall at the time of payment deduct income tax thereon at 43.2% during the financial year 1990-91 for the assessment year 1991-92. It was the same rate during the financial year 1989-90 for the assessment year 1990-91 in the case of resident non-corporate tax-payers. The amount of tax deducted at source shall be credited in the account of the assessee in his individual assessment,

Look at Illustration 1 and 2 and see how the income from other sources is worked out :

Illustration 1

Mr. X is a Member of Parliament from Lucknow. During the previous year 1989-90 he had the following incomes.

- i) As a Member of Parliament he received a salary of Rs. 1,000 per month and daily allowance of Rs. 7,000 for attending various sessions.
- ii) He held the following investments:
 - a) 10% Preference Shares in Daurala Sugar Factory Ltd. of the face value of the Rs. 6,000.
 - b) 2,000 Equity Shares of Rs. 10 each in D.C.M. Ltd. The company declared Interim Dividend of 10% on 15th March, 1990 but paid it on 15th April 1990 and declared a final dividend of 10% on 31st March, 1990.
 - c) A 10% Fixed Deposit of Rs. 15,000 is held by him in State Bank of India, Lucknow. Interest is credited annually.
- iii) He won Rs. 10,000 in Crossword Puzzles.
- iv) On 1st August 1989 he purchased a plot of land for constructing his house. On account of shortage of funds, he could not get his house constructed and hence let out the plot at Rs. 200 p.m. from 1st September, 1989.

- v) He has let machinery and furniture and also building to Mr. Y at a monthly rent of Rs. 6,000. He spent Rs. 2,000 on the repair of machinery, furniture and building during the previous year. Depreciation allowed in respect of these assets for the previous year was Rs. 12,000.

The Bank charged Rs. 25 commission on collection of dividends.

Compute the taxable income of Mr. X under the head Income from Other Sources.

Solution

Computation of Taxable Income under the head 'Income from Other Sources for the Assessment Year 1990-91:

	Rs.
1) Salary as Member'of Parliament (Rs. 1,000 p.m. for 12 months)	12,000
2) Dividend on Preference Shares	600
3) Final Dividend on Equity Shares	2,000
4) Interest on Fixed Deposit	1,500
5) Winning from Crossword Puzzles in excess of Rs. 5,000 (Rs. 5,000 is exempt)	5,000
6) Rent of land for 7 months (from September 89 to March, 90)	1,400
7) Rental income from Machinery, Furniture and Building	72,000
Less Repairs	2,000
Depreciation	12,000
	14,000
	58,000
	80,500
Less Bank Commission	25
Income from Other Sources	Rs. 80,475

Note : 1) Daily Allowance of Members of Parliament for attending Sessions is exempt u/s 10(17).

- 2) Interim Dividend has been received during the previous year 1990-91, hence it is not taxable in the Assessment Year 1990-91.

Illustration 2 .

Dr. Puri is a Professor of Economics and is a resident in India, He submits before you the following incomes for computing his income under the head 'Income from Other Sources' the assessment year 1990-91.

- 1) He is the author of a text book which fetched him a gross royalty income of Rs. 50,000. He claims the following expenses regarding earning this royalty income:
 - a) Salary to a clerk who collects for him necessary data and goes through the final proof regarding Rs. 500 p.m.
 - b) Cost of books purchased in connection with the revision work of the book Rs. 1,000.
 - c) Telephone Expenses of Rs. 1,800 attributed to the publication and sale of his book and other matters in connection with the printing of the new edition of the book.
- 2) Income from Research Papers published in 'Taxation' and 'Taxmann' Rs. 4,000.
- 3) He lives in a rented house paying rent of Rs. 600 p.m. The house is too big for, his family. Hence he has sub-let one-third portion of the house on a rent of Rs. 350 per month. Dr. Puri has undertaken the liability of paying municipal taxes of Rs. 600 on the whole house and also the current repairs of the whole house amounting to Rs. 900.
- 4) Dr. Puri received Rs. 75 per lecture delivered at the Institute of Management. During the previous year he delivered 20 lectures.
- 5) He is an examiner in a number of Universities, from which he got a remuneration of Rs. 3,000.

- 6) His other incomes were:
 - i) Winnings from Card Games Rs. 8,000
 - ii) Received interest on Government Securities of U.K. Government Rs. 1,500.
- 7) Received Rs. 2,500 as dividend from a company in which the public are substantially interested by an account payee cheque.

Solution:

Computation of Taxable Income under the head '**Income** from Other Sources' for the Assessment Year 1990-91:

		Rs.
1) Income from Royalty	50,000	
Less Expenses incurred:		
i) Salary to clerk	6,000	
ii) Cost of books purchased	1,000	
iii) Telephone Expenses	1,800	
	8,800	41,200
2) Income from Research papers published		4,000
3) Income from sub-letting:		
Rent Received	4,200	
Less Rent paid for 1/3rd portion	2,400	1,800
Less Proportionate Expenses...		
1/3 Municipal Taxes	200	
1/3 Repairs	300	500
		1,300
4) Income from Lectures		1,500
5) Income from Examinership		3,000
6) Income from Foreign Govt. Securities		1,500
7) Income from Card Games in excess of Rs. 5,000 exempt u/s 10(3)		3,000
8) Dividend (Not to be grossed up as it is received by account payee cheque from a company in which the public are substantially interested and is not more than Rs. 2,500)		2,500
Income from Other Sources Rs.		58,000

Check Your Progress A

- 1) State whether the following statements are True or False?
 - i) Any income other than the incomes under the head Salary, House Property, Business or Profession and Capital Gains, is included in Income from Other Sources.
 - ii) Interim Dividend is the income of shareholders of the previous year in which the interim dividend is declared.
 - iii) Final Dividend is the income of the shareholders of the previous year in which the amount of such dividend is released for payment to shareholders.
 - iv) Income tax deducted at source from the dividend declared is to be included in the dividend income of the shareholders.
- 2) Fill up the blanks in the following sentences:
 - i) Winnings from crossword puzzles is a..... income but is taxable under the head.....
 - ii) The rate of deduction of tax at source from payments of winnings from lottery is..... during the financial year 1990-91.
 - iii) Cost of purchasing lottery tickets is..... from the amount of ,winnings received.

10.6 INTEREST ON SECURITIES

Interest on Securities if charged under the head 'income from other sources' means the following:

- i) Interest on any security of the Central or State Government;
- ii) Interest on debentures or other securities for money issued by or on behalf of a local authority;
- iii) Interest on debentures issued by a company (whether Indian or foreign); and
- iv) Interest on debentures or other securities issued by a Statutory Corporation.

Security means an acknowledgement of a debt represented by a debenture, bond, etc., issued by the Central or any State Government, local authority, statutory corporation, or a company. Even securities issued by a foreign government or foreign company are covered by this definition of securities and interest thereon will be chargeable as interest on securities.

10.6.1 Basis of Charge

- 1) Income from interest on securities is chargeable on due basis if the assessee follows mercantile system of accounting. In case books are maintained on cash basis this income is taxable on receipt basis. However, where no method of accounting is regularly employed by the assessee, the **income** from interest on **securities** shall be chargeable to tax as the income of the previous year in which it becomes due though it **may** be received **later**.
- 2) Interest on securities does not accrue from day to day but becomes due on certain fixed dates only; which are mentioned on the security itself. It means that interest on securities is chargeable to tax in the hands of one who holds the securities, as owner, on the due date of interest. Where securities are sold before the due date of interest, the entire amount of interest payable on the next due date shall be deemed to be the income of the buyer who holds the securities on the said due date as owner thereof. This amount will **not** be apportioned on time basis between the seller and the buyer, whether it is bought and sold on cum-int. basis or **ex.int.** basis.
- 3) Interest on securities shall be chargeable to tax under the 'Business or Profession' if securities are held as stock-in-trade or under the head 'Income from Other Sources', if securities are held as investments.

10.6.2 Kinds of Securities

Securities may be (1) Government Securities and (2) Commercial Securities.

Government Securities may further be sub-divided into (i) Less Tax Securities and (ii) Tax-free Securities. Similarly Commercial Securities may also be sub-divided into (i) Less Tax Securities and (ii) Tax-free Securities.

1) Government Securities

- i) **Less Tax Government Securities** : In the case of these securities, income tax is deducted at source on the account of interest calculated at the percentage stated on the securities and the balance of the amount of interest left after deduction of the aforesaid income tax is paid to the security-holder. In this case the gross amount of interest (calculated at the rate per cent given on the security) is liable to tax in the hands of the owner of the securities, and the tax deducted at source will be deducted from the total tax payable by the assessee.
- ii) **Tax-free Government Securities** : Securities, the interest on which is exempt from tax and also excluded from computation of total income in case of all assesseees are called tax-free government securities. These are fully exempted securities. There are no partially exempted government securities. Government specifically declares certain securities to be tax-free. However, there are some persons who are exempt **from** tax regarding their income from interest from government securities (even if they are, otherwise, taxable); but it does not mean that these are tax-free securities. It is only the holder who is exempt.

2) Commercial Securities

- i) **Less Tax Commercial Securities** : These are just like the less tax government securities. The only difference is that these are issued by some company or corporation and the government securities are issued by the government. From tax point of view there is no difference between the two.

- ii) **Tax free Commercial Securities** : These are issued by a company or some other business-institution. Really speaking, their interest is not tax-free, because tax due on this interest is payable by the company or the business institution concerned. These are called tax-free because the entire amount of interest due is paid to the assessee without deduction of tax at source and the assessee has not to pay tax on it from his own pocket. The tax paid by the company on this interest is deemed to have been paid on behalf of the assessee, hence the relevant amount of tax paid on any interest due to an assessee is added up in his interest income, i.e., the interest due to an assessee is grossed up and then this grossed up amount is included in his total income. No relief is granted on this interest, except that the amount of tax paid by the company on this interest is deducted from the total tax payable by the assessee on his total income, and the balance of amount left is payable by the assessee as tax. For example, if a company has issued 10% tax-free Debentures, the debenture-holder will receive the entire amount of interest calculated at 10% but the amount to be included in the total income of the debenture-holder will be the amount actually received by him as interest plus income tax thereon paid by the company. The net amount of income tax payable by the debenture holder will be the total tax payable by him on his total income minus the tax paid by the company on his behalf on interest on debentures.

10.6.3 Grossing up of Interest on Securities

The following are the rules for grossing up interest on securities:

- 1) If the rate of interest is given, only the interest of tax-free commercial securities is grossed up and interest on all other securities is not grossed up.
- 2) Interest on tax-free commercial securities is always grossed up whether its rate per cent is given or the amount received is given.
- 3) Interest on less tax securities is grossed up only when the amount received is given.

The following formula may be used to find out the gross amount in different circumstances (for the assessment year 1990-91):

In case of a person other than a company:

- a) where the person is resident in India:
 - i) interest received on tax-free government securities — Never grossed up.
 - ii) Interest received on government securities or debentures of a company which are listed in a recognised stock exchange in India —
Stock Exchange in India —

$$\text{Interest received} \times \frac{100}{89.2}$$
 - iii) Interest received on other debentures and other securities not listed in a recognised stock exchange

$$\text{Interest received} \times \frac{100}{78.4}$$

- b) Where the person is non-resident in India:

- i) Interest received on tax-free government securities:

$$\text{Interest received} \times \frac{100}{85}$$

- ii) Interest on other securities:

$$\text{Interest received} \times \frac{100}{70} \text{ or}$$

Interest received plus tax deducted at source, whichever is higher.

It should be clearly understood that the taxable income from interest on securities is (i) net interest received by the security-holder plus (ii) the amount of income tax deducted at source or paid by the authority responsible for paying the interest, directly into the government treasury on behalf of the security-holder.

10.6.4 Bondwashing Transactions

These transactions are not genuine. It is a device to avoid tax. Generally, interest on securities is payable half-yearly or yearly on fixed dates. As the whole amount of interest is regarded as the income of the person who happens to be the owner on the due date of interest, some tactful persons sell their securities a few days before the due date of interest, to some of their friends or relatives and buy it back a few days after the due date. Thus they do not remain the owner of the securities on the due date and they are not required to pay tax on this income from interest on securities. They sell their securities to such persons whose total income including the income from interest on securities either does not exceed the minimum taxable limit or if it exceeds that limit it is lesser than that of the seller, so that either no tax will be payable on such interest or it will be payable at a lower rate. Thus the seller escapes tax completely; and the buyer also does not pay tax on it as his income is below the minimum taxable limit; and even if the buyer's income exceeds the minimum taxable limit, he will pay tax at lower rate, which is in fact, secretly paid by the seller on behalf of the buyer. Such transactions are called 'Bondwashing Transactions'. The general rule that tax is payable by the person who is the owner of the securities on the due date of interest does not apply to bondwashing transactions. In order to prevent this device of avoiding tax, it has been provided that the Assessing Officer can include the whole interest in respect of bondwashing transactions in the income of the transferor and not in the income of the transferee.

10.6.5 Interest on Securities Exempt from Tax

According to Section 10(15) the interest on certain securities is fully exempt from tax. They are:

- 1) Income by way of interest, premium on redemption or other payment on such securities, bonds, annuity certificates, savings certificates, other certificates issued by the Central Government and notified in this behalf to the extent of as notified.

Under clause (i) the interest/premium on the following securities/bonds shall be fully exempt:

- i) 12 years National Savings Annuity Certificates.
- ii) National Defence Gold Bonds, 1980.
- iii) Special Bearer Bonds, 1991.
- iv) Treasury Savings Deposit Certificates (10 years).
- v) Post Office Cash Certificates (5 years).
- vi) National Plan Certificates (10 years).
- vii) National Plan Savings Certificates (12 years).
- viii) Post Office National Savings Certificates (7 years/12 years).
- ix) Post Office Savings Bank Account.
- x) Post Office Cumulative Time Deposit Rules, 1981.
- xi) Scheme of Fixed Deposits governed by the Government Savings Certificates (Fixed Deposits) Rules, 1968.
- xii) Scheme of Fixed Deposits governed by the Post Office (Fixed Deposits) Rules, 1968.
- xiii) Special Deposit Scheme, 1981.

Further interest on Public Account shall be exempt upto Rs. 5,000.

Under the Post Office Savings Bank Rules a 'Public Account' can be opened by a local authority, a lawfully constituted association, institution or other body for the encouragement of thrift or for the mutual benefit of its members and a High School and Intermediate College (Payment of Salaries of Teachers and other Employees) Act, 1971.

- 2) (iia) 7% Capital Investment Bonds held by individual and H.U.F. assessee only.
- 3) (iib) In the case of an individual of Hindu undivided family, interest on 9% Relief Bonds shall be exempt.
- 4) (iic) Interest on the notified bonds arising to following is exempt subject to certain conditions:
 - a) a non-resident Indian, being an individual owning the bonds; or

- b) any individual owning the bonds by virtue of being a nominee or survivor of such non-resident Indian; or
- c) by an individual to whom the bonds have been gifted by Non-resident Indian.

Illustration 3

The investments of Mr. X on 1st April 1989 were as given below:

- a) Rs. 30,000, 10% U.P. Government Loan;
- b) Rs. 10,000, 10% Debentures of a Jute Mill company.
- c) Rs. 2,000 Interest received on Debentures of a Co-operative Society.
- d) Rs. 15,000, 6% Securities issued by a Foreign Government.
- e) 7% National Plan Certificates Rs. 10,000.
- f) Rs. 1,500 received as dividend on units of Unit Trust of India.
- g) Rs. 3,568 received as interest on less tax Government Securities.

The Bank commission for collecting interest is Rs. 30: Interest on securities being payable in each case on 1st January and 1st July. Find out income from other sources for the assessment year 1990-91.

Solution

Income from Other Sources :	Rs.
a) Int. on 10% UP Govt. loan for 1 year	3,000
b) Int. on 10% Debentures of a Jute Mill Company for 1 year.	1,000
c) Interest on Debentures of a Co-operative Society (Not to be grossed up)	2,000
d) Interest on foreign government securities (Not to be grossed up)	900
e) Interest on National Plan Certificates	Exempt
f) Dividend from U.T.I. (Not to be grossed up)	1,500
g) Interest received on less tax govt. securities Grossed up	$\frac{3,568 \times 100}{89.2}$
	4,000
	12,400
Less Bank Commission for collecting Interest	<u>30</u>
Income from Other Sources.....	12,370

- Notes :** 1) Interest from co-operative society, foreign government securities, and dividend from U.T.I. is never grossed up.
2) Interest on National Plan Certificates is exempt from tax.

Illustration 4

Mr. Y has the following investments in the previous year ended on 31st March, 1990:

- i) Rs. 10,000 Equity Shares of Thapper & Company Limited on which a final dividend of 10% declared on 28th February 1990, which was received by Mr. Y on 15th April, 1990.
- ii) Rs. 12,000 Equity Shares of Birla Jute Limited on which an interim dividend 10% was declared on 15th February, 1990 but paid on 15th April, 1990.
- iii) Rs. 45,000 Tax Free Debentures of a limited company (not listed on any stock exchange) on which Rs. 3,528 received as interest.
- iv) 10% Rs. 10,000 U.P. State Electricity Board Bonds.
- v) Rs. 10,000 in Post Office Savings Bank Account on which Rs. 600 credited as interest during the year.
- vi) Rs. 10,000 9% National Rural Development Bonds.
- vii) Special Bearer Bonds of Rs. 10,000 on which a premium of Rs. 1,000 received during the year.

- viii) On 1st September 1989 he bought 7% Capital Investment Bonds of the face value of Rs. 20,000 at par, for which he took a loan of Rs. 10,000 @ 10% p.a. on the same date.

Find out the income from other sources for the assessment year 1990-91.

Solution

Computation of Income from Other Sources for the Assessment Year 1990-91: Rs.

i) Final Dividend on Equity Shares	1,000
ii) Interim Dividend on Equity Shares not taxable in the A.Y. 1990-91 as it is received in the previous year 1990-91 assessable in A.Y. 1991-92	Nil
iii) Interest on tax-free Debentures of a company (not listed) grossed up	4,500
$\frac{3,528 \times 100}{78.4}$	
iv) Interest on U.P.S.E.B. Bonds	1,000
v) Interest on Post Office Savings Bank A/c	Exempt
vi) Interest on National Rural Development Bonds	900
vii) Premium on Special Bearer Bonds	Exempt
viii) Interest on Capital Investment Bonds	Exempt
	<u>Rs. 7,400</u>

- Notes :**
- 1) Interest on P.O. Savings Bank A/c is totally exempt.
 - 2) Interest on Capital Investment Bonds is exempt u/s 15 (iib).
 - 3) Premium on Special Bearer Bonds is exempt u.s. 15(i).
 - 4) Interim dividend is taxable for the year in which it is released for payment, and not in the year of declaration.
 - 5) Interest on loan for purchasing exempted securities is not deductible as its income is not taxable. Interest on Capital Investment Bonds is exempt, hence-interest on loan taken to purchase them is not deductible.

Check Your Progress B

- 1) Fill up the blanks in the following sentences:
 - i) Security means an acknowledgement of a debt represented by..... issued by the Central or any State Government, local authority or a Company etc.
 - ii) Where no method of accounting is regularly employed by the assessee, the income from interest on securities is chargeable to tax on.....basis.
 - iii) Interest on securities does not.....but becomes due on certain fixed dates only.
 - iv) Where securities are sold in between the due dates of interest, the.....amount of interest due on the next due date is deemed to be the income of the.....
 - v) Bondwashing transactions are not....., it is a device.....
- 2) State whether they are True or False:
 - i) Interest on debentures issued by a foreign company is not treated as interest on securities.
 - ii) If any security is bought from a person in between the two due dates of interest, the buyer will pay tax on interest for only the remaining period before the next due date, i.e., the period during which the buyer was the owner of the security,
 - iii) There is no exception to the rule that interest is deemed to be the income of the person who owns the security on the due date.

- iv) From the point of view of security-holder there is no difference between a tax-free government security and tax-free commercial security.
- v) Even if the rate of interest is given, the interest on tax-free commercial security is always grossed up.

10.7 SET-OFF AND CARRY FORWARD OF LOSSES

Set-off of losses means setting-off losses against the income of the same year. Where it is not possible to set-off the losses during the same assessment year in which they occurred so much of the loss as has not been so set-off out of certain specified losses can be carried forward for being set-off against his income in the succeeding years provided the losses have been determined in pursuance of a return filed by the assessee within the time allowed u/s 139(1) or within such further time as may be allowed by the Assessing Officer and it is the same assessee who sustained the loss and the business is continuing.

10.7.1 Inter-Source Adjustment

Where there is more than one source of income under the same head, the loss from one or more sources is allowed to be set-off against the income from the other sources. It means that where the net result for any assessment year in respect of any source falling under any head of income is a loss, the assessee shall be entitled to have the amount of such loss set-off against the income from any other source under the same head. This is called inter-source adjustment. For example, suppose an assessee has four house properties. Three of them yield net taxable income; but from the fourth there is net loss. The assessee can set off the loss of one house property against the income of the remaining house properties. Similarly, if an assessee has four businesses of different nature, in a particular year suppose from two businesses there is taxable profit and from the remaining two businesses there is loss. The loss of these two businesses can be set off against the profits of the other two businesses.

Exceptions

- 1) Speculation losses can be set off only against profits, if any, of another speculation business' carried on by the assessee. They cannot be set-off either against any other regular business or against any other head of income.
- 2) Losses from the activity of owning and maintaining race horses in any assessment year shall be set-off only against income from owning and maintaining race-horses only and not against any other income.
- 3) Losses from other businesses will not be allowed to be set-off against winnings from races, lotteries, etc.

10.7.2 Inter-Head Adjustment

Where in respect of any assessment year the net result of the computation under any head of income is a loss, the assessee shall be entitled to have the amount of such loss set-off against his income, if any, assessable under any other head of income. There are, however, certain exceptions to this general rule, which are as under:

Exception : Loss under the head 'Income from House Property' on account of unrealised rent. Such loss cannot be set-off against income under any other head.

Thus, the loss from 'non-speculative business' or 'capital losses (whether short-term or long-term) may be set-off against the income falling under any other head 'Salaries', 'Income from House Property', 'Capital Gain', 'Income from other sources' (excluding winning from races, lotteries etc.).

10.7.3 Set-Off of Capital Losses

Such losses can be set-off against the gain from any other short-term capital assets or long-term capital assets as well as against the income under any other head of income. Long-term capital losses will be scaled down in the same manner and by the same percentage of deduction, as are allowed out of long-term capital gains and thereafter,

the balance of long-term capital losses shall be set-off against income under any other head in the same year as business losses.

10.7.4, Carry Forward and Set-Off of Capital Losses

Capital Losses (Whether short-term or long-term) : Capital losses which cannot be wholly or partially set-off in the same assessment year, against income under any other head, shall be carried forward to the following assessment year and shall be set-off against income, if any, under the head capital gains. If the entire amount of carried forward capital loss cannot be set-off in the following assessment year, the amount remaining unabsorbed shall be carried forward to be set-off against capital gains in subsequent years upto a maximum of eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Special provisions regarding long-term capital losses of assessment years prior to the assessment year 1988-89 carried forward to the assessment year 1988-89 or any subsequent year:

Carried forward long-term capital losses of any assessment year prior to the assessment year 1988-89 shall be dealt with in the assessment year 1988-89 or any subsequent assessment year in the following manner:

It shall be reduced by the deductions specified in Section 48(3) (i.e., first Rs. 10,000 plus 10% or 30% of the balance in the case of a company, and 50% or 60% in the case of any other assessee depending on the category of the asset concerned) and the reduced amount shall be carried forward and set-off against income under the head 'capital gains'; but such carry forward shall not be allowed beyond the fourth assessment year immediately succeeding the assessment year for which the loss was first computed.

Illustration 5

Mr. X, a resident of India submits the following particulars of his income for the assessment year 1990-91:

	Rs.
1) Income from house let out (Computed)	15,000
2) Profit from cloth business	20,000
3) Speculation income	2,000
4) Short-term capital gains	4,000
5) Long-term capital gains from shares	20,000

The following items have been brought forward from the preceding assessment year 1989-90.

i) Loss from Iron business discontinued during the previous year (1988-89)	4,000
ii) Loss from cloth business	2,000
iii) Speculation loss	3,000
iv) Short-term capital loss for the assessment year 1987-88	4,500
v) Long-term capital loss from land for the year 1987-88 before deduction u/s 48(3)	18,000

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

Solution

Treatment of Carried-Forward Losses

	Rs.
1) Business Income (Cloth)	20,000
Less Cloth Business Loss b/fd	2,000
	<u>18,000</u>
2) Speculation Business Income	2,000
Less Speculation Loss b/fd	3,000
Speculation Loss c/fd.....	<u>1,000</u>

Other Heads of Income

3) a) Capital Gains			Rs.
i) Short-term capital gain			4,000
ii) Long-term capital gain regarding shares	20,000		
Less deduction u/s 48(2):			
Initial	10,000		
60% of balance of Rs. 10,000	<u>6,000</u>	<u>16,000</u>	<u>4,000</u>
			8,000
b) Capital Losses			
i) Long-term capital loss from land	18,000		
Less Deduction u/s 48(3):			
Initial	10,000		
50% of the balance of Rs. 8,000	<u>4,000</u>	<u>14,000</u>	<u>4,000</u>
ii) Short-term capital loss	<u>4,500</u>		<u>-8,500</u>
'Capital loss carried forward			Rs. <u>500</u>

Statement of Gross Total Income

1) Income from House Property			Rs.
2) Income from Business			15,000
3) Capital Gains			18,000
			Nil
	Gross Total Income	Rs.	<u>33,000</u>

Notes :

- 1) Losses of business which are discontinued or whose ownership is changed cannot be carried forward for set-off in subsequent years. As iron business has been discontinued its loss cannot be carried forward and set-off.
- 2) Speculation loss can be set-off against speculation profits only.
- 3) Brought forward short-term capital loss can be set-off against short-term as well as long-term capital gains.
- 4) Brought forward long-term capital losses can be set-off against short-term as well as long-term capital gains; but before being set-off such long-term capital loss has to be reduced as provided under Section 48(3).

Illustration 6

Mr. Y furnishes the following particulars of his income for the assessment year 1990-91.

1) Income from salary	Rs.
2) Interest on securities (gross)	21,000
3) Dividends (gross)	10,000
4) Profits from a proprietary business	10,000
5) Profit from speculation in shares	40,000
6) Profit from speculation in wheat	15,000
7) Loss from speculation in silver	15,000
8) Short-term capital loss	35,000
9) Long-term capital loss from sale of machinery (before scaling down u/s 48(3))	9,000
10) Profit from horse-racing	50,000
11) Loss in crossword puzzles	8,000
12) Profit in rummy (card games)	2,000
13) Loss in flash (card games)	5,000
14) Brought forward capital loss (long-term) in respect of sale of building in the previous year 1988-89 after deduction u/s 48(3)	7,000
	10,000

Compute his gross total income for the assessment year 1990-91.

Solution

Income from Other Sources

		Rs.
1)	Income from salary	21,000
	Less standard deduction @ 33 ¹ / ₃ %	<u>7,000</u>
		14,000
2)	Profit of proprietary business	40,000
3)	Speculation Business	
	Profit from speculation in shares	15,000
	Profit from speculation in wheat	<u>15,000</u>
		<u>30,000</u>
	Less loss from speculation in Silver	<u>35,000</u>
	Carried forward speculation loss	<u>5,000</u>
4)	Capital Loss	
i)	Short-term capital loss	-9,000
ii)	Long-term capital loss on sale of machinery.....	50,000
	Less deduction u/s 48(3):	
	Initial	10,000
	60% of the balance	
	of Rs. 40,000	<u>24,000</u>
		<u>34,000</u>
		<u>-16,000</u>
		-25,000
5)	Income from Other Sources	
	Interest on securities	10,000
	Dividends	10,000
	Profit from horse-racing	8,000
	Profit from Rummy (card game)	<u>5,000</u>
		<u>13,000</u>
	Less : Exempt u/s 10(3)	<u>5,000</u>
		<u>8,000</u>
		<u>28,000</u>
	Gross Total Income	Rs. <u>57,000</u>

Notes

- 1) Brought forward capital loss can be set-off only against capital gains. As there are no capital gains this loss has again been carried forward to be set-off in subsequent years against capital gains.
- 2) Loss of crossword puzzles and card games cannot be set-off against any income, whatsoever.

Check Your Progress C

- 1) Fill up the blanks in the following sentences:
 - i) Set-off of losses means setting-off losses against the income of the..... year.
 - ii) Set-off of loss of one source against income of other source under the same head of income is called.....
 - iii) Business loss which **cannot** be set-off against any income in the same assessment year **can** be **carried** forward for.....years to be set-off.
 - iv) Long-term capital loss which cannot be set-off against any income in the same assessment year can be **carried** forward for.....years.
- 2) State whether they are True or False :
 - i) Speculation business losses can be set off against profits of regular business.
 - ii) Non-speculative (regular) business losses can be set-off against speculation business profits.
 - iii) When inter-source adjustment exhausts, inter-head adjustments begins.
 - iv) Loss under the head,house property-can be carried forward for eight years to be set-off in the following and subsequent seven years.

- v) If a **speculation** business is discontinued its brought forward losses cannot be carried forward any further to be set-off against profits of any other speculation business.

10.8 LET US SUM UP

Any income which, though to be included in total income but does not find place under **any other** head of income, is taxable under the head 'Income from Other Sources'. It includes dividends; income from winnings from lotteries, crossword puzzles, horse **aces**, card games or betting etc., interest on securities, income from letting of machinery, plant or furniture which is not chargeable as business income, etc.

In case of dividends or interest on securities any commission paid to a banker or any other person for collecting the dividends or interest on behalf of the **assessee** is deductible from such income.

In case of income from letting of machinery, plant or furniture alongwith letting of buildings, which is chargeable under the head 'Other Sources' deduction in respect of repairs, insurance premium and depreciation of buildings, machinery, plant or furniture shall be allowed..

In **the case** of income from family pension received by the widows or heirs of deceased employee, a deduction of a sum equal to $33\frac{1}{3}\%$ of **such** income or Rs. 12,000, whichever is less, is to-be allowed.

Any other revenue expenditure incurred wholly and exclusively for the purpose of earning such income is allowed. **Dividends** are classified into two types—final dividend and interim dividend. Final dividend is deemed to be the income of the previous year in **which** it is declared and interim dividend is deemed to be the income of the year in which it is **released** for payment. **Dividends are to be grossed up before including in the total income as income tax paid by company is also the income of the assessee.** However, the tax paid by the company will be deducted from the total tax payable by the assessee. Winnings **from** lotteries, crossword puzzles etc. are casual. in nature and therefore this income in excess of **Rs. 5,000** is taxable under the head 'Other Sources'.

Interest on Securities : Any security issued by the Central or State **Government** or local authority or any company or a statutory corporation is a security for this purpose. Any interest earned on such securities is taxable under the head 'Other Sources', generally, on due basis. Interest on securities is deemed to be due on the due date of interest and does not **accrue** from day to day. Securities can be : Government Securities and Commercial Securities. Securities may also be less tax and tax-free. Commercial tax-free securities are, in fact, not tax free but tax on interest on such securities is paid by the Company paying interest on behalf of the security holder. Like dividends, the interest also should be grossed **up** before it is included in the total income of the assessee.

The Deductions permissible from interest income include : (i) bank commission for collecting interest and (ii) interest on loan taken to purchase the securities.

Set-off of losses means setting-off losses against the income of the same year. Where it is not possible to set-off the losses during the same assessment year in which they occurred, so much **of the** loss as has not been so set-off out of certain specified losses can be carried forward for being set-off against his income in the succeeding years. **Set-off** can be inter-source and **inter-head**. Inter-source means when loss of one source is set-off against the income of some other source under the same head of income. Inter-head means when a loss remains unabsorbed from **inter-source** set-off, the balance of it can be set-off against income **under other head** of income.

So far as capital losses are concerned (whether **long-term** or short-term) they can be set-off against the gain from any other long-term capital assets or short-term capital assets as well as against the income under **any other** head of income. Long-term capital losses shall be scaled down in the same manner and by the same percentage of deduction as are allowed out of long-term capital gains and thereafter **the balance** .

of long-term capital losses shall be set-off. Capital losses which cannot be wholly set-off in the same assessment year against income under any other head, shall be carried forward to the following assessment year/years and shall be set-off against income if any, under the Capital Gains.

10.9 KEY WORDS

Bondwashing Transactions : When securities are sold near the due date of interest to some friend or relative with an intention to buy back after the due date of interest, it is a bogus transaction, as it is a device to avoid tax. Such transactions are called Bond-washing Transactions.

Dividends : Any distribution by a company of accumulated profits in any form which results in reduction of assets or increase of liabilities or distribution at the time of liquidation of the company, of by way of reduction of capital is called dividend.

Interest on Securities : Interest on securities means interest on any security of the Central or State Government or interest on debentures issued by a local authority or a company or a Statutory Corporation.

Inter-head Adjustment : Where in respect of any assessment year the net result of the computation under any head of income is a loss. He shall be entitled to have the amount of such loss set-off against his income, if any, under any other head of income. This is called Inter-head Adjustment.

Inter-source Adjustment : When there is more than one source of income under the same head, the loss from one or more sources is allowed to be set-off against income from the other source under the same head. It is called Inter-source Adjustment.

Less-Tax Securities (both Government and Commercial) : On such securities the rate of interest is given. The interest calculated at this rate is gross amount of interest from which tax is deducted at source.

Tax-free Commercial Securities : These are issued by a company or some other business institution. Really, their interest is not tax-free but the tax on this is paid by the business institution concerned on behalf of the debenture holder over and above the interest, which is fully paid to the debenture holder.

Set-off of losses : Setting off losses against the income of the same year.

Carry forward of losses : The losses which cannot be set off in the same year are carried to next year to set-off against income of next year.

10.10 ANSWERS TO CHECK YOUR PROGRESS

- A 1) i) False; ii) False; iii) False; iv) True.
 2) i) Casual; Income from other sources.
 ii) 43.2% iii) not allowed as deduction.
- B) 1) i) Debenture, bond etc. ii) due iii) accrue from day to day
 iv) entire, buyer v) genuine, to avoid tax.
 2) i) False, ii) False, iii) False, iv) False, v) True.
- C 1) i) Same, ii) inter-source adjustment, iii) eight, iv) eight.
 2) i) False, ii) True, iii) True, iv) False, v) False.

10.11 TERMINAL QUESTIONS/EXERCISES

Questions

- 1) Explain clearly the meaning of the term 'dividend' as defined in the Indian Income-Tax Act, and point out the law relating to taxation of dividends.
- 2) Discuss the various kinds of securities? Explain the rule regarding grossing up of interest on Tax-Free Commercial Securities.

- 3) Explain Bond Washing Transactions? How it is a device to avoid tax?
- 4) Discuss the provisions relating to set-off of losses in the following cases :
 - i) Speculation loss,
 - ii) Short-term Capital Loss,
 - iii) Long-term Capital Loss,
 - iv) Losses from horse-race, gambling and crossword puzzles.
- 5) Discuss the conditions subject to which losses are allowed to be set-off in the **current** year and **carried** forward.

Exercise

- 1) Mr. X furnishes the following particulars of his income for the previous year ending on 31st March, 1990:
 - i) Dividend from a tea company Rs. 2,500 (gross) (60% of the income of the company is not taxable).
 - ii) Amount won on 1st **November 1989** from a horse race Rs. 2,500.
 - iii) Interim Dividend declared by the directors of A Co. Ltd. **in** January 1990 but the payment was made in **June** 1990 for **which** dividend warrants were despatched **in** May 1990. Amount received as dividend was Rs. 7,800.
 - iv) Final dividend declared by B Co. Ltd. in January, 1990, 'dividend warrants were despatched in April, 1990 and the payment was received in June, 1990 amounting to Rs. 4,000.
 - v) Winning from a lottery Rs. 62,500.
 - vi) Received refund **from** **Compulsory** Deposit Scheme (Income-tax payer's) Rs. 1,000 principal deposit and Rs. 200 interest.
 - vii) Interest received on deposit with a firm Rs. 5,352.
 - viii) **Dividend** received **from** a co-operative society Rs. 450.
 - ix) **Income** from non-agricultural land Rs. 1,500. Mr. X claims the following expenses:

Bank Commission for collecting dividend Rs. 100; Interest on **loan** taken to purchase shares in tea company Rs. 800; and expenses incurred for purchasing lottery tickets **Rs.** 2,000. Compute the taxable income of Mr. X under the head 'Income from Other Sources' for the Assessment Year 1990-91.
(Answer : Rs. 73,750)
Hint : **Interest received from a firm** Rs. 5,352 will be grossed up at the rate of 10.8% T.D.S. (**Tax** deduction at source) which will amount to Rs. 6,000.
- 2) From **the** following particulars of Mr. P for the assessment year 1990-91, compute his income from other sources:
 - i) Rs. 3,136 received as dividend on tax-free Public Ltd. Company's Shares.
 - ii) Rs. 3,568 received as interest on U.P. Govt. Securities.
 - iii) He holds Rs. 10,000 units of Unit Trust of India on which a dividend of Rs. 1,200 has been received during the previous year.
 - iv) He received Rs. 1,000 **as interest** on the debentures of the co-operative society.
 - v) He holds Rs. **35,680, 10%** Tax-free Debentures of **Delhi** Municipal Corporation.
 - vi) Rs. 1,500 received by an Account Payee Cheque as interest on debentures (Listed) of a company in which the public are substantially interested. He collected the entire interest and dividends himself and charged Rs. 200 collection fees.
 - vii) Mr. P had set up a factory with building, plant, machinery, furniture etc. However, he decided to give it on hire at **Rs.** 2,000 per month. During the year he spent **Rs.** 2,000 for repair and Rs. 500 for insurance. The depreciation allowable is Rs. 5,000. He had borrowed Rs. 30,000 against mortgage of these assets and paid **Rs.** 3,000 **interest thereon**. The amount we spent for the marriage of his daughter.
(Answer : Rs. 32,200)

- Hints :** 1) Collection fees is not deductible as he himself collected the interest (United Commercial Bank v. CIT(1953) 4 ITR p. 425).
- 2) Tax-free dividend on shares has been grossed up at the rate 21.6% TDS and interest on U.P. Govt. securities and Tax free Debentures of D.M.C. have been grossed up at the rate of 10.8% TDS.
- 3) Dividend from U.T.I. and interest on debentures of co-operative society are not to be grossed up as no TDS is done in these cases.
- 4) Interest on Debentures of Rs. 1,500 received by Account Payee is also not to be grossed up as the amount does not exceed Rs. 2,500.
- 3) A resident assessee, furnishes the following particulars for the accounting years ended on 31st March 1989 and 1990:

Accounting Year ending on 31.3.1989

	Rs.
Silver Speculation Business Loss brought forward (Discontinued in 1987-88)	10,000
Profit of Cloth Business	35,000
Saw Mill Business Profit	25,000
Accounting Year ending on 31.3.1990	
Gold Speculation Business Profit (newly started this year)	50,000
Loss of cloth business	10,000
Saw Mill Business Loss	14,000
Profit from a business adventure in foreign country not brought to India	35,000

Compute the gross total income of the assessee for the assessment years 1989-90 and 1990-91.

(Answer : 1989-90 Rs. 60,000; 1990-91 Rs. 51,000.)

Hint : Silver speculation loss shall be carried forward to 1990-91.

Discontinuance of speculation business is immaterial.

.Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

SOME USEFUL BOOKS

Bhagwati Prasad, *Law and Practice of Income Tax*, Navaman Prakashan, Aligarh (Chapter 8, 10 & 11).

Mahesh Chandra & Goyal S.P., *Income Tax Law and Practice*, 1990, Himalaya Publishing House, Delhi (Chapters 7, 10 & 11).

Mehrotra, H.C. *'Income Tax Law and Accounts'* 1990, Sahitya Bhawan, Agra (Chapters 6, 9 & 10).

Vinod K. Singhania, *Students Guide to Income Tax*; Taxman, Publications Private Ltd. (Chapters 6, 8 & 9).

UNIT 11 DEDUCTIONS FROM GROSS TOTAL INCOME

Structure

- 11.0 Objective
- 11.1 Introduction
- 11.2 Deductions from Gross Total Income
- 11.3 Deductions to Encourage Savings
 - 11.3.1 Based on Gross Amount of Savings
 - I. In respect of Life Insurance Premium etc. (Sec. 80-C)
 - II. In respect of Investment in Certain New Shares (Sec. 80-CC)
 - 11.3.2 Based on Net Savings
 - I. In respect of Deposit in National Saving Scheme etc. (Sec. 80-CCA)
 - II. In Respect of Investment in Equity Linked Savings Scheme (Sec. 80-CCB)
 - 11.3.3 Based on Income from Specified Investment (Sec. 80-L)
- 11.4 Deductions for Certain Personal Expenditure
 - 11.4.1 Medical Treatment (Sec. 80-D)
 - 11.4.2 Maintenance of Handicapped Dependents (Sec. 80-DD)
 - 11.4.3 For Payment of House Rent (Sec. 80-GG)
- 11.5 Deductions for Encouraging Voluntary Participation in Charitable and Socially Desirable Activities
 - 11.5.1 Contribution to Charitable Trusts/Associations Societies (Sec. 80-G)
 - 11.5.2 Contribution to Certain Approved Associations (Sec. 80-GGA)
- 11.6 Deductions for Economic Growth :
 - 11.6.1 For Setting up New Industrial Units Anywhere (Sec. 80-I)
 - 11.6.2 For Setting up New Industrial Units in Backward Areas (Sec. 80-HH)
 - 11.6.3 For Setting up Small Scale Units in Rural Areas (Sec. 80-HHA)
 - 11.6.4 For Encouragement to Poultry Farming (Sec. 80-JJ)
- 11.7 Deductions in Respect of Earnings in Foreign Exchange
 - 11.7.1 In Respect of Income from Project Export (Sec. 80-HHB)
 - 11.7.2 In Respect of Income from Export of Goods and Merchandise (Sec. 80-HHC)
 - 11.7.3 In Respect of Income of Tour Operators and Hotels (Sec. 80-HHD)
 - 11.7.4 In Respect of Remuneration of Teachers, Professors etc. (Sec. 80-R)
 - 11.7.5 In Respect of Income Earned by Artists, Authors and Playwriters (Sec. 80-RR)
 - 11.7.6 In Respect of Income of Certain Technicians Rendering Services Abroad (Sec. 80-RRA)
- 11.8 Deduction in case of Totally Blind or Physically Handicapped Resident Persons
- 11.9 Let Us Sum Up
- 11.10 Keys Words
- 11.11 Answers to Check Your Progress
- 11.12 Terminal Questions/Exercises

11. OBJECTIVES

After studying this Unit you should be able to :

- list the deductions available from gross total income;
- calculate the amount of each deduction; and
- compute the taxable income of an assessee after allowing such deductions.

1 1 INTRODUCTION

Indian tax laws contain certain provisions which are intended to act as an incentive for achieving certain desirable socio-economic objectives. These provisions are contained in Chapter VIA and are in the form of deductions from the Gross Income. By reducing the chargeable income, these provisions reduce the taxable liability, increase the post-tax income and thus induce the tax-payers to act in the desired manner. This Unit is intended to give a broad idea of such deductions.

1 2 DEDUCTIONS FROM GROSS TOTAL INCOME

The first step in the computation of income is to work out the income under the individual heads of income. Computation under each head takes into account the expenditure incidental to earning such income. The aggregate of income under each head is known as "Gross Total Income". Certain deductions which are not necessarily referable to any particular head are allowed out of Gross Total Income to arrive at the Total Income liable to tax.

Total income is accordingly computed as under :

1) Income from Salaries	—		—
2) Income from House Property	—		—
3) Profit and Gains of Business and Profession	—		—
4) Income from Capital Gains	—		—
5) Income from other sources	—		—
Gross Total Income.	—		—
Less deduction under Chapter VI-A	(-)		—
Total Income			—

These deductions are discussed in 11.2 to 11.7 below.

11.3 DEDUCTIONS TO ENCOURAGE SAVINGS

These deductions are allowed if the tax-payer makes savings and invests it in specified areas. Some of these are based on gross amount of savings, which means that benefit allowed is not withdrawn when the saved amount is disinvested after the specified period. There are others which give tax benefit only on net savings. Deduction is allowed when the saving is deposited/invested but any withdrawal/disinvestment is treated as income in the year of withdrawal. Thus only the net saving gets tax benefit.

Deduction is also allowed in respect of income from certain investments.

11.3.1 Based on Gross Amount of Savings

I. In respect of Life Insurance Premium etc. (Sec. 80-C)

This section provides for deduction in respect of the undermentioned payments and contributions :

- a) Payments in respect of life insurance premia;
- b) Payments made to effect or keep in force a contract for deferred annuity;
- c) Contribution to a Recognized Provident Fund;
- d) Subscriptions to the Public Provident Fund Scheme;
- e) Deposits under Post Office Savings Bank (Cumulative Time Deposits) Rules 1959;
- f) Contributions to an Approved Superannuation Fund;
- g) Contributions for participating in the Unit-linked Insurance Plan;
- h) Subscriptions to National Saving Certificate;
- i) Deposits with the National Housing Bank;
- j) Payments in respect of purchase or construction of a residential house.

The deduction, however, is admissible subject to the limits of the amount qualifying for the same and certain conditions laid down in the sections. In case of authors, playwrights, artists, musicians, actors or sportsmen including athletes, the limit of amount qualifying for the deduction is Rs. 60,000 or sums actually paid, whichever is least.

In case of other individuals and Hindu Undivided families this limit is Rs. 40,000.

Quantum of deduction : The quantum of deduction in respect of the qualifying amount is :

at 100% on the first 6,000

at 50% on the next 6,000 and
at 40% on the balance of the qualifying amount.

Switch over to system of Granting Tax Rebate

The above mentioned system of granting deduction, on a slab basis is **applicable upto** the assessment year 1990-91. For Assessment year 1991-92 and onwards there is a switch over to a system of granting tax rebates. Thus under the new provisions the tax liability of the **assessee** will be computed and a tax rebate of 20 per cent of the qualifying savings would be allowed.

The **maximum** tax rebate admissible is Rs. 10,000 generally. However, in case of authors, playwrights, artists, **mucians**, actors or **sportmen** the limit is Rs. 14,000.

Conditions for deduction

As stated earlier these deductions are available subject to certain conditions. These are discussed below :

- a) **For Life Insurance Premium:** Payments **made** on account of Life Insurance Premium would be eligible for **deduction/rebate** if:
 - i) the insurance premium is paid in order to effect or keep in force an insurance on the life of the assessee, **his/her spouse** or child.
 - ii) the premium paid in excess to 10% of the capital sum assured does not qualify for deduction.
 - iii) where the tax payer terminates a policy of Life **Insurance** before paying premium for 2 years, no deduction will be allowed in respect of premium paid in the year in which the policy is terminated. Further the amount of deduction allowed in respect of premium paid in the preceding year will be deemed to be income of the year in which the policy is terminable.
- b) **Payments for deferred annuities:** Any sum paid in order to effect or keep in force, a contract for deferred annuity provided such contract does not contain a provision for an option to be the insured to receive a **cash** payment in lieu of the **payment** of annuity.
 - i) in case of **an individual** on his own life or the life of his spouse or child,
It is important to note that the restriction in respect of sums paid in excess of 10% of capital sum assured does not apply to deferred annuity policies.
- c) **Contribution to recognised provided fund:** Where the **assessee** is an employee participating in a recognised provided fund, his own contribution to **the fund** shall be deductible **upto** one-fifth of his salary. 'Salary' for this purpose includes dearness allowance if the terms of employment so provide but it does not **include** any other allowance or 'Perquisites'.
- d) **Subscription to the Public Provident Fund Scheme:** This scheme was introduced by the Government for the benefit of self-employed persons such as doctors, lawyers ktc. in particular. Under it an individual may subscribe to the fund on his own behalf and also on behalf of a minor ward.

The salient features of the scheme are —

- i) An account can be **opened** at any branch of State Bank of India and its subordinate or at any head Post Office or at some related branches of other nationalised banks.
- ii) Subscription **may** be of any amount not less than Rs. 100 and not more than Rs. 60,000 in every financial year.
- iii) Loans from the funds are permitted in or after the third year of opening the account; of an amount up to **25%** of the balance to the credit of the **assessee** **at the end** of the 2nd preceding financial year. Interest is charged at 13% and the loan is repayable in 24 months.
- iv) Withdrawals are also permitted every year between the 6th and 15th year of an amount **not exceeding 50%** of the balance to the credit of the assessee at the end of the 4th year immediately preceding the year of **withdrawal** or at the end of the preceding year whichever is lower.
- v) A **person** can continue his account after 15 years with or without fresh subscription for a block period of 5 years.

- e) **Deposits in 10 years or 15 years** account under the **Post Office Savings Bank (Cumulative Time Deposits) Rules 1959**: The minimum deposit under this scheme is Rs. 10 with multiples of Rs. 5 and the maximum limit is Rs. 1,000 per month. A loan up to 50% of the balance is permitted twice in a period of 10 years. An individual can make deposit in more than one account e.g. in the name of the wife, children, etc.
- f) Contribution to an approved superannuation fund by an employee qualifies for deduction.
- g) Contribution for participating in the Unit linked insurance plan: Any sum paid by an individual as contribution for participation in the Unit Linked Insurance Plan, 1971 of the Unit Trust of India qualifies for deduction. It is important to note, however, that if a member terminates his participation before making contribution for a period of 5 years, no deduction will be **allowed** in respect of contribution made in such year. Besides, an aggregate of deduction allowed in respect of contribution to the plan in past years will be included in the total income of the **previous year** in which he terminates his participation in the plan.
- h) Subscription to National Savings **Certificates**: This deduction is available to individuals and H.U. Funds subscriptions to **NSCs VIII** issues carry an interest of 12% per annum.
- i) Deposits with National Housing Bank with effect from the A. Y. 1990-91, any sum paid as subscription to any deposit scheme of the National Housing Bank is also deductible.
- j) Payments in respect of purchase or construction of a residential **house**: This provision has been introduced **w.e.f.** the assessment year 1988-89 onwards. Any sum paid (up to a maximum of Rs. 10,000) by an individual or a HUF for the residential house property the construction of which is completed after 31.3.1987, are eligible for deduction, provided such payments are made towards or by way of :
- i) any **instalment** of amount due under any self-financing or other scheme of any development authority or housing board engaged in the construction and sale of house property on ownership basis, or
 - ii) any instalment or part payment of the amount due to any company or cooperative society of which the **assessee** is a shareholder or **member** towards the **cost** of the house property allotted to him, or
 - iii) re-payment of the amount borrowed by the **assessee** from
 - a) the Central Government or any State Government, or
 - b) any bank, including a cooperative bank, or
 - c) the Life Insurance Corporation, or
 - d) the National House Bank, or
 - e) any public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or **purchase** of houses in India for residential purpose and approved in this regard, or
 - f) any compgny in which the public are substantially interested or any cooperative society, where such company or cooperative society is engaged in the business of financing the construction of houses, or
 - g) the assessee's employer where such employer is a public company or a public **sector** company or a University established by law or a college affiliated to **such** a University or a local authority.
 - iv) Stamp duty, registration fees and other expenses for the **purpose** of transfer of such house property to the assessee.

There **are** however, **certain payments which** are not eligible for **deduction**. They **include** :

- i) admission fees, cost of share or initial deposit paid by a shareholder of company or a member of a cooperative society to become such shareholder or member, or
- ii) Cost of **the** land, except where the **construction** for the purchase of the house property is a composite amount and the cost of land cannot be ascertained separately, or
- iii) **Cost** of any addition or alteration to or renovation or repair of the house property

which is carried out after the house property or any part thereof has either been occupied by the assessee, or

- iv) any expenditure in respect of which deduction is allowable while computing income from house property u/s 24.

The house property for which deduction is so claimed must not be transferred by the assessee before a period of 5 years from the possession of the same. If he does so the deduction allowed will be added back as income from other sources in the previous year in which the transfer takes place.

Look at Illustration 1 and see how amount for deduction u/s 80-C is calculated :

Illustration 1

An individual who has a gross total income of Rs. 1,00,000 makes following payments:

i) Life Insurance premium on a policy of Rs. 30,000	4,000
ii) Contribution to Statutory Provident Fund	24,000
iii) Repaid loan in respect of residential house constructed in 1988.	15,000
iv) Purchased National Savings Certificates VIII Issue	10,000

Solution

i) The qualifying amount is restricted to 10% of the policy amount	3,000
ii) Contribution to P.F.	24,000
iii) Qualifying amount in respect of such payment is restricted to 10,000	10,000
iv) Purchase of N.S.C. VIII Issue	10,000
	<u>47,000</u>

The overall qualifying amount is restricted to 40,000. Hence, only 40,000 will qualify for deduction at the following rate:

First 6000	—	100%	6,000
Next 6000	—	50%	3,000
Balance 28,000	—	40%	11,200
			<u>20,200</u>

The total income will be —

Gross Total income	1,00,000
Less deduction u/s 80-C	20,200
	<u>79,800</u>

N.B.—The above position is applicable to assessments up to the assessment year 1990-91. With effect from assessment year 1991-92, there will be no deduction in respect of such payments and the tax will be worked out on the total income (without any deduction for such payments). The tax so worked out will be reduced by 20% of the overall qualifying amount which has been raised to Rs. 50,000 and the balance amount will be the net tax payable. In the above example, tax will be worked out on 1,00,000 which for 1991-02 will be Rs. 27,600. Out of this, 20% of Rs. 47,000, i.e. Rs. 9,400 will be deducted leaving Rs. 18,200 (plus surcharge) as tax-payable.

II: In Respect of Investment in Certain New Eligible Shares (Sec. 80-CC)

- 1) **Deduction** equal to 50% of the total investment is allowed in respect of—
 - i) equity shares forming part of any eligible issue of capital and
 - ii) Units of Unit Trust of India or any other Mutual Fund Issued under a Scheme in which the amount of subscription is used for subscribing only the equity shares of the type referred in (i) above.
- 2) 'Eligible issue of Capital means on issue which satisfies following conditions —
 - i) It is made by a company formed and registered in India which is engaged in construction or manufacturing of articles (not being non-priority articles in eleventh schedule) or providing long-term finance for residential houses or a hospital or a hotel or operation of ships.
 - ii) The issue is made by the company for the first time. (This condition does not apply in the case of issues made by shipping companies.)

- iii) The issue is offered for subscription before 1.4.1990.
- 3) The qualifying amount for such deduction is restricted to Rs. 20,000 and the amount of deduction at the rate of 50% is thus restricted to Rs. 10,000.

N.B.—The above position is applicable up to assessment year 1990-91 only. With effect from the assessment year 1991-92, the system of deduction from Gross Total Income will be replaced by deduction from the tax chargeable on income computed before allowing such deduction. The qualifying amount of deduction will be Rs. 25,000 and the deduction from tax will be allowed of an amount calculated at 20% thereof. This means that the credit in tax on this account will be restricted to Rs. 50,000.

For assessment year 1991-92, the issue will be considered as an eligible issue if offered for subscription before 1.4.1991 (in place of 1.4.1990 for earlier assessment years—Please refer to condition in para 2(iii))

Check Your Progress A

- a) An individual purchased a life insurance policy for Rs. 1,00,000 maturing after 5 years. Annual premium payable is Rs. 20,000.
 - i) What will be the qualifying amount of deduction available for the assessment year 1990-91? Rs. _____
 - ii) What will be relief for assessment year 1991-92, presuming he has not made any other saving? Rs. _____
- b) An individual paid a premium of Rs. 3,000 on a life policy of Rs. 1,00,000 and contributed Rs. 24,000 towards a Recognised Provident Fund. He purchased National Savings Certificates VIII issue of Rs. 10,000 and subscribed Rs. 12,000 to the Home Loan Scheme of National Housing Bank. What will be the deduction admissible for the assessment year 1990-91? Rs. _____
- c) An individual, a government employee completed construction of a residential property in April, 1988. He had taken a house building advance of Rs. 2,50,000 from the Government for which a deduction of Rs. 2000 per month is being made from his salary. What will the total income for the assessment year 1990-91 if the gross total income from all sources is Rs. 90,000. Rs. _____
- d) An individual whose gross total income is Rs. 78,000 purchased 'Can XCCC UNITS (Units of Canara Bank, the proceeds of which is required to be invested in new eligible issues only) of the value of Rs. 25,000. He contributed Rs. 200 per month to the Public Provident Fund.
Find out his total income for the year 1990-91.

11.3.2 Based on Net Savings

I. In Respect of Deposits in National Saving Scheme etc. (See. 80-CCA).

Deduction is allowed in full in respect of the following deposits/payments in the year of such deposits/payment:

- i) deposit in accordance with the notified National Savings Scheme.
- ii) payment towards a notified annuity plan of the Life Insurance Corporation of India. (So far the 'Jiwan Dhara' and 'Jiwan Akshy' plan of the LIC has been notified.)

The qualifying amount for such deduction is

For assessment year 1988-89 actual or Rs. 20,000 whichever is less

For assessment year 1989-90	-do-	Rs. 30,000	-do-
For assessment year 1990-91	-do-	Rs. 30,000	-do-
For assessment year 1991-92			
and subsequent years	-do-	Rs. 40,000	-do-

The interest accrued on the deposits shall not be chargeable to tax from year to year.

Whenever any amount in respect of which deduction was allowed in the year of deposit is withdrawn, the amounts together with interest withdrawn by the tax-payer is treated as the income of the tax-payer of the year in which withdrawal is made and charged to tax along with other income at the normal rate applicable to him. If, however, the tax-payer dies without making the withdrawal and the withdrawal is

made by his legal representatives, the withdrawal having not been made by the tax-payer himself will not be charged to tax. With effect from the assessment year 1991-92 if the deposit was made by the HUF and the HUF is partitioned, the individual member who makes the withdrawal will be taxed in respect of the amount withdrawn by him. The same rules are applicable when the amount of annuity is received from the LIC under a policy in respect of which deduction was allowed when payment was made by the tax-payer.

II. In Respect of Investment in Equity Linked Savings Scheme (Sec. 80-CCB)

Where an individual or a HUF acquires Units of Unit Trust of India or any other recognised mutual fund under any plan which is formulated under the notified equity linked saving scheme, he shall be entitled to full deduction in respect of such investment subject to the maximum of Rs. 10,000.

As in the case of deposit under National Savings Scheme, whenever any such investment is returned to the assessee in whole or in part either by way of repurchase of the unit or on termination of the plan in any previous year, the entire amount (including the accretion) received back will be charged to tax as the income of the previous year in which it is received.

If in the meantime, a partition is made in the HUF or dissolution takes place in the AOP (Association of Persons) which initially made the investment, the return of investment will be taxable in the hands of the person who takes it.

11.3.3 Based on Income from Specified Investments (Sec. 80-L)

Deductions, subject to the monetary limit specified in para 2 below is allowed in respect of following investment income —

- i) Interest on any security of Central Government or State Government.
- ii) Interest on notified debentures issued by certain authorities.
- iii) Interest on National Savings Certificate VI and VII Issues.
- iv) Interest on deposits under any notified Scheme of the Central Government.
- v) Interest on deposits under Post Office (Monthly Income Account) Rules, 1987.
- vi) Interest on deposits with Banking companies including co-operative banks.
- vii) Interest on deposits with financial institutions providing long-term finance for industrial development approved for the purpose of Section 36(1)(viii).
- viii) Interest on deposits with authority constituted for satisfying the housing needs etc.
- ix) Interest on deposits with co-operative societies.
- x) Dividend on shares of co-operative societies.
- xi) Interest on deposits with or dividend from shares of a public company providing long-term finance for construction or purchase of residential houses and which is approved for the purposes of Section 36(1)(viii).
- xii) Income from Units of recognised Mutual Funds.
- xiii) Income from Units of Unit Trust of India.
- xiv) Interest on deposits under National Deposits Scheme framed and notified by the Central Government.
- xv) Dividend on shares of Indian companies.

The deduction is limited in the aggregate to Rs. 7,000.

However, if the Gross Total Income includes Items (xi), (xii) and (xiv) an additional deduction can be allowed in respect of these amounts to the extent deduction in respect of such income is not fully allowed within the limit of Rs. 7000. Such additional deduction will not exceed Rs. 3000.

Further if deduction in respect of income from interest on deposits under National Deposit Scheme and dividend from shares of Indian companies is not fully allowed within the above limits of Rs. 7000 and Rs. 3000 a further additional deduction can be allowed to the extent of unallowed position. This further additional deduction will not exceed Rs. 3000.

The net effect is that with properly planned investment, one can get a total deduction of Rs. 13,000.

Look at the Illustration 2 for clear understanding of deduction u/s 80 L.

Illustration 2

1) Interest on National Savings Certificate VI Issue	...	Rs. 4,000
2) Interest on deposits with Banks	...	Rs. 2,000
3) Interest on deposit with Housing Society [Item (xi)]	...	Rs. 2,000
4) Income from Mutual Fund	...	Rs. 500
5) Dividend from shares of Indian companies	...	Rs. 4,000
		Rs. 12,500

Solution

Following deduction will be allowed :

i) Overall general deduction	...	Rs. 7,000
ii) Additional deduction for 3 & 4 to the extent not met (2500-1000)*	...	Rs. 1,500
iii) Further additional deduction for 5 i.e. dividend to the extent not met or Rs. 3,000 whichever is less	...	Rs. 3,000
		Rs. 11,500

* **Note :** Deduction of Rs. 1,000 in respect of 3 & 4 has already been included in Rs. 7,000.

Check Your Progress B

- a) A Professor having Gross Total Income of Rs. 80,001 has kept his saving made out of this income in following:
- | | | |
|--|-----|------------|
| 1) Paid Life Insurance Premium | ... | Rs. 5,000 |
| 2) Repaid loan for construction of property (completed in June 1987) | ... | Rs. 15,000 |
| 3) Contributed to Recognised Provident Fund 10% of salary | ... | Rs. 6,000 |
| 4) Deposited under the National Saving Scheme | ... | Rs. 9,000 |
- Find out the total income for 1990-91.
- b) A person deposited Rs. 20,000 on 30.3.1988 under the National Saving Scheme and got deduction in the year 1988-89. What will be the tax treatment if
- he withdraws Rs. 10,000 in June 1992 when the balance in the account including interest and further deposit is Rs. 32,000.
 - he dies in September 1990 and the balance in the account is withdrawn by his son in June, 1992.
- c) An individual's gross total income of Rs. 50,000 includes —
- | | | |
|---|-----|-----------|
| i) Interest from fixed deposit with Bank | ... | Rs. 3,000 |
| ii) Interest from National Saving Certificates VI issue | ... | Rs. 3,000 |
| iii) Interest from Tata Chemicals | ... | Rs. 2,000 |
| v) Dividend from Indian Companies | ... | Rs. 3,000 |
| v) Income from UTI | ... | Rs. 5,000 |
- Is any deduction admissible to him? What will be his total income for 1990-91?

11.4 DEDUCTIONS FOR CERTAIN PERSONAL EXPENDITURE

Under Section 80-D, 86-DD and 80-GG of IT Act 1961 some deductions are allowed in respect of personal expenditure. Let us now discuss these three sections one by one.

11.4.1 For Medical Treatment (Sec. 80-D)

deduction is allowed in respect of any sum paid out of chargeable income by cheque towards an insurance policy taken on the health of the assessee or his wife/husband or dependent parents or dependent children.

The deduction is subject to a maximum amount of Rs. 3,000, provided the scheme for insurance is framed by GIC and approved by Central government under Section 80-D the Income Tax Act 1961.

11.4.2 Maintenance of Handicapped Dependents (Sec. 80-DD)

Deduction is allowed to a resident individual in respect of expenditure incurred for medical treatment (including nursing), training and rehabilitation of a handicapped relative who is dependent upon him and is not dependent on any other person for support or maintenance. A handicapped relative means a relative who is suffering from permanent physical disability (including blindness) or who is subject to mental retardation. They should be of the nature specified in I.T. Rules and should be certified as such by a physician, a surgeon, an oculist or a psychiatrist working in a government hospital. Further, it should have the effect of reducing considerably such persons capacity for normal work or engaging in gainful employment or occupation.

The deduction will be allowed of a fixed sum of Rs. 0,000. This deduction is irrespective of actual expenditure.

It applies from the assessment year 1991-92.

Deduction is not admissible in cases where the total income before deduction under this section exceeds Rs. 1 lakh.

11.4.3 For Payment of House Rent (Sec. 80-GG)

Deduction is allowed to an assessee in respect of payment of rent of the premises occupied by him for his own residence. This deduction is permissible of an amount by which the rent paid exceeds 10% of the total income.

Thus, if total income is Rs. 50,000 and rent paid is Rs. 7,000, permissible deduction will be 7,000 — 10% of 50,000, i.e. Rs. 2,000.

But even the amount calculated as above is restricted to —

- i) Rs. 1000 per month or
- ii) 25% of total income whichever is less.

Thus, in the above case if the rent paid was Rs. 20,000, the excess over 10% of total income would have been Rs. 15,000 which would have been further restricted to Rs. 1,000 per month, i.e. Rs. 12,000.

This deduction is not allowable to an employee getting house rent allowance from his employer, the exemption in respect of which is governed by the provisions of Section 10(13A).

Total income for this purpose means the gross total income reduced by all the deductions under this Section,

Check Your Progress C

Indicate whether any deduction is admissible. Also quantify the amount of deduction :

- a) 1) An expenditure to meet cost of children's education
- 2) An expenditure to meet cost of medical treatment
- 3) Premium paid for life insurance on the life of
 - i) Self
 - ii) Wife/Husband
 - iii) Minor Son
 - iv) Dependent Mother
- 4) Premium in respect of medical insurance on the health of
 - i) Self
 - ii) Wife/Husband
 - iii) Dependent Son

- iv) Independent Son
 - v) Dependent Father
 - vi) Dependent Sister
- 5) Sum spent on treatment of
- i) handicapped dependent sister
 - ii) handicapped dependent sister-in-law
- 6) Sum spent for purchase of books required for employment
- 7) i) Rent paid for a house belonging to wife
- ii) Rs. 6,000 paid as rent by one whose total income is Rs. 75,000
 - iii) Rent paid for house in respect of which house rent allowance is admissible.
- b) An individual whose gross total income is Rs. 50,000 and who is entitled to a deduction of Rs. 10,000 under Section 80-C. 80-CC incurred an expenditure of Rs. 1,500 per month on house-rent. Is he entitled to any deduction. If yes, how much?
- c) An individual who has a permanently physically handicapped brother totally dependent upon him incurs an expenditure of Rs. 3,000 on his treatment.
- i) Is he entitled to any deduction? If so, what is the amount of deduction?
 - ii) How much deduction he would have got if he had another handicapped dependent relative and incurred expenditure on the treatment of both.

11.5 DEDUCTIONS FOR ENCOURAGING VOLUNTARY PARTICIPATION IN CHARITABLE AND SOCIALLY DESIRABLE ACTIVITIES

The Income Tax Act, 1961 also allows certain deduction for the contribution made, in the charitable and socially desirable activities. These are explained in Section 80-G and 80-GGA.

11.5.1 Contribution to Charitable Trusts/Associations/Societies (Sec. 80-G)

- 1) Contribution made to following trusts, associations or societies qualify for deduction —
- i) National Defence Fund
 - ii) Jawaharlal Nehru Memorial Fund
 - iii) Prime Minister's Drought Relief Fund
 - iv) Prime Minister's National Relief Fund
 - v) Prime Minister's Armenia Earthquake Relief Fund
 - vi) National Children's Fund
 - vii) Indira Gandhi Memorial Trust
 - viii) Any other fund or institution to which Section 80-G applies
 - ix) Government or any local authority to be utilised for charitable purpose other than promotion of family planning
 - x) Housing authorities mentioned in Section 10(20A)
 - xi) Government or such local authority, institution or association as are approved if the payment is for promoting family planning
 - xii) For renovation or repairs of such temple, mosque, guardwara, church etc. as are notified to be of historic, archaeological or artistic importance.
- 2) The deduction will be 100% of the qualifying amount in respect to payments mentioned in (iv), (v) and (xi) and 50% of the qualifying amount in respect of the rest.
- 3) The qualifying amount will be determined as under :
- i) If the aggregate of the amount paid is less than Rs. 250, no deduction will be allowed.
 - ii) If the aggregate of items referred in items (viii), (ix), (x), (xi) and (xii) exceeds 10% of the Gross Total Income (as reduced by all deductions except this one) the aggregate qualifying amount for these items will be restricted to 10%.

- 4) Regarding item mentioned in (viii), i.e., contribution to any other fund or institution to which this section applies, it is necessary that the fund etc. should comply with following conditions :
- i) the income of such fund, institution etc, should be exempt by reason of its charitable other provisions exempting income viz. educational institutions [10(22)], hospitals etc., [10(22A)], sports associations [10(23)], Regimental Fund established by Armed Forces [10(23AA)] or other funds mentioned in Section 10(23C);
 - ii) the rules should not permit application on transfer of any part of income or asset for any purpose other than charitable purposes;
 - iii) the institution etc. should not be for the benefit of any particular community;
 - iv) the institution etc. should maintain regular accounts of income and expenditure;
 - v) the institution etc. should be constituted either as a public charitable trust or registered under Societies Registration Act or under Section 25 of Indian Companies Act or should be a University established by law or should be any other educational institution recognised by or affiliated to any University or an institution approved for the purpose of Section 10(23C) or an institution financed by the Government or local authority.

Look at Illustration 3 and see how the amount of deduction u/s 80G is regulated.

Illustration 3

A person with gross total income of Rs. 80,000 for the assessment year 1990-91 is entitled to deduction of Rs. 10,000 (under Section 80-C) for life insurance premium etc. Further he made following donations:

i) to National Defence Fund	1,000
ii) to Prime Minister's National Relief Fund	2,000
iii) to a charitable hospital whose income is not to be taxed under Section 11	5,000
iv) to an educational institution whose income is exempt u/s 10(22)	5,000
	13,000

Solution

Qualifying Amwnt

i) National Defence Fund	1,000
ii) Prime Minister's National Relief Fund	2,000
iii) charitable hospital and	7,000
iv) educational institution 10% of (80,000-10,000)	70,000
	10,000

Deduction

i) 50% or 1,000	500
ii) 100% or 2,000	2,000
iii) & iv) 50% of 7,000	3,500
	6,000

Total Income

Gross Total Income	80,000
Less deduction u/s 80-C	10,000
	70,000
Less deduction u/s 80-G	6,000
	64,000

11.5.2 Contribution to Certain Approved Institutions (Sec. 80-GGA)

- 1) Deduction is allowed in respect of—
 - a) Contribution to an **approved** scientific research association or to an approved University, College or other Institution to be used for scientific research.
 - b) Contribution to an association or institution having the object of undertaking an approved programme of rural development.
 - c) Contribution to an approved association or institution having the object of undertaking an approved programme of conservation of natural resources or afforestation.
 - d) Contribution to notified fund for afforestation.
 - e) Contribution to notified Rural Development Fund.
 - f) Contribution to an association or institution which has as its object the training of persons for implementing programmes of rural development.
- 2) These deductions are not to be allowed to an **assessee** deriving income from business or profession. In his case, these contributions are allowed in the computation of the business income.

Check Your Progress D

- a) How much deduction is admissible u/s 80-G in each case to a salaried employee presuming that no other donation is made and the total income before such deduction is Rs. 50,000.

	Deduction
i) Rs. 10,000 to National Defence Fund	... Rs. _____
ii) Rs. 10,000 to Prime Minister's National Relief Fund.	... Rs. _____
iii) Rs. 7,000 to the institution for promotion of family planning	... Rs. _____
iv) Rs. 6,000 for renovation of mosque notified as of historic importance	... Ra. _____
v) Rs. 200 for Adarsh Vidyalaya whose income is not taxable under Section 10(22)	... Rs. _____
vi) Rs. 2,500 for Cancer Society of India to which Section 80-G applies	... Rs. _____

- b) How much deduction is admissible in respect of the following:
 - i) Rs. 1,000 to an approved University for scientific research
 - ii) Rs. 2,000 to an institution set up for rural development for carrying out an approved rural development programme approved having been granted in 1982
 - iii) Rs. 3,000 to Rural Development Fund

What will be the position if these payments were made by a doctor having independent private practice?.

- c) Work out the taxable income for the assessment year 1990-91 from the following:
 - 1) Income under the head 'Salary' Rs. 43,000
 - 2) Income under the head 'Other Sources' Rs. 8,000
 - 3) Income under the head 'Other Sources' includes Rs. 3,000 interest from the Bank, Rs. 3,000 income from UTI and Rs., 2,000 interest from Reliance Industries
 - 4) He deposited Rs. 5,000 under the National Savings Scheme
 - 5) He contributed Rs. 700 per month to a Statutory Provident Fund
 - 6) Donated Rs. 700 to Blind Relief Society to which provisions of Section 80-G apply.

11.6 DEDUCTIONS FOR ECONOMIC GROWTH

In order to encourage the new industrial units for the overall balanced economic growth of the country, the IT Act 1961 allows certain deductions. These deductions are as follows:

11.6.1 For Setting up New Industrial Units Anywhere (Sec. 80-I)

- 1) Deduction is allowed out of income from a new industrial undertaking at the following rates:
 - i) If the industrial undertaking begins to manufacture or produce articles or operate cold storage prior to 1.4.1990 ... 20% of the profit
 - ii) If these operations start on or after 1.4.1990 ... 25%

- 2) These deductions are allowed in the initial year in which the industrial undertaking begins production and the following seven years. In effect, therefore, the deduction is allowed in 8 assessment years.

If, however, these operations commence on or after 1.4.1990, the deduction will be allowable for initial years and the following nine years. This means that deduction will be allowed for 10 assessment years.

- 3) Deduction is allowed only to those undertakings which fulfil all the following conditions:
 - a) the new undertaking is not formed by the splitting up or reconstruction of already existing business;
 - b) it is not formed by transfer to a new business of machinery or plant previously used for any purpose. This condition will not apply in the case of **second-hand** imported machinery which at no time was used in India and in respect of which no depreciation was allowed or allowable in India. This condition will also not apply if the total value of transferred machinery or plant does not exceed 20% of the total value of machinery or plant used in that business;
 - c) the new undertaking begins operating at any time within a period of fourteen years next following the 31st day of March, 1981;
 - d) the new undertaking, if it is not a small scale industrial undertaking, produces any article other than those mentioned in Eleventh Schedule (Eleventh Schedule consists of non-priority items such as cigarettes, liquor, cosmetics etc.);
 - e) the new undertaking employs ten or more workers if the **manufacturing** process is carried on with the aid of power and twenty or more workers if the process is carried on without the aid of power.

11.6.2 For Setting up New Industrial Units in Backward Areas (Sec. 80-WW)

- 1) Deduction is allowed out of profit from an industrial undertaking or hotel set up in any backward area at the rate of 20% of such profit for a period of ten years, beginning with the year in which the industrial undertaking begins manufacture or hotel starts functioning. Backward area means such area which has been notified by the Central Government as backward area having regard to its stage of **development**.
- 2) This deduction applies only to those undertakings which fulfil the following conditions:
 - i) it begins to manufacture or the hotel begins to function after 31st December, 1970;
 - ii) it is not formed by splitting up or the reconstruction of a business already in existence in any backward area;
 - iii) it is not formed by the transfer to a new business of machinery or plant previously;

This condition will not apply if the total value of transferred machinery or plant does not exceed 20% of the total value of machinery or plant used in the business;

- iv) it employs at least ten workers if the manufacture is **with** the aid of power and at **least** twenty workers if the manufacture is without the aid of power;
 - y) in the case of hotels, they should be approved for the purpose by the Central Government.
- 3) If the industrial undertaking is also a small scale undertaking set up in a rural area and has claimed deduction under Section 80-HI-IA (to be discussed later in 11.5.3), this deduction will not be allowed.
 - 4) This deduction will not be allowed in respect of undertakings or Hotels beginning manufacture (in the case of hotels starting to function) on or after 1st April, 1990. This means that the deduction has been discontinued in respect of undertakings/hotels coming into existence now.

11.6.3 For Setting up Small Scale Units in Rural Areas (Sec. 80-HHA)

- 1) This deduction is allowed out of profits and gains of new small scale industrial undertaking set up in rural areas. The undertaking should be one which begins to manufacture after 30th September 1977 and which complies with all other conditions which are laid down for the undertakings qualifying for deduction under Section 80-HH (Refer 11.5.2—Para 2).
- 2) This deduction is also admissible for a period of ten previous years beginning with the previous year in which the industrial undertakings begin to manufacture or produce articles. The amount of deduction is 20% of the profits or gains derived from such undertaking.
- 3) If, however, an undertaking qualifies for deduction under Section 80-HH (applicable to undertakings in backward areas) also and claims deduction under that Section, no deduction will be allowed under this Section.
- 4) This deduction will not be allowed if the undertaking begins to manufacture articles on or after 1st April, 1990.

11.6.4 For Encouragement to Poultry Farming (Sec. 80-JJ)

Deduction is allowable out of profit and gains of the business of poultry farming at the rate of 33 $\frac{1}{3}$ % thereof.

This deduction is allowable for and from the assessment year 1990-91.

11.7 DEDUCTIONS IN RESPECT OF EARNINGS IN FOREIGN EXCHANGE

There are certain deductions which are allowed in order to boost exports and earn foreign exchange. These are explained u/s 80-HHB, 80-HHC, SO-HHD, 80-HR, 80-HRR, 80-HRRA.

11.7.1 In Respect of Income from Project Exports (Sec. 80-HHB)

- 1) This deduction is allowable only to an individual who is resident in India.
- 2) The deduction is allowable out of the profits and gains derived from the business of—
 - a) execution of foreign project, or
 - b) execution of any work forming part of a foreign project undertaken by any other person.

In both the cases, the contract should be with the foreign government or any foreign authority or agency or a foreign enterprise.

- 3) The amount of allowable deduction is 50% of the profits and gains from the execution of such projects/work.
- 4) The deduction is allowable only if the consideration for execution of such project/work is payable in convertible foreign exchange.

- 5) The deduction is allowable subject to the fulfilment of following conditions:
- Separate accounts for such projects/works should be maintained and got audited by a Chartered Accountant.
 - A reserve of an amount equal to 50% of the profit from such project/work should be created by credit to 'Foreign Projects Reserve Account'. This reserve should be utilised in the next five years for the purposes of the business but not for distribution by way of profit. If the amount is utilised within five years for any other purpose or for distribution as profit, the deduction shall be considered to be wrongly allowed and the assessment shall be rectified to withdraw such deduction.
 - At least 50% of the profits or gains from such project/work should be actually brought in India in convertible foreign exchange within six months of the end of the previous year. If, for unavoidable reasons, it is not possible to do so, the Commissioner/Chief Commissioner can extend this time.

Where the amount credited to Foreign Project Reserve Account--or the amount actually remitted to India is less than 50% of such profits the deduction is restricted to the amount credited or actually brought into India whichever is less.

11.7.2 In Respect of **Income from Export of Goods or Merchandise** (Sec. 80-HHC)

- This deduction is allowable only to an individual who is resident in India.
- The deduction is allowable out of profit derived from the export of goods or merchandise. It, however, does not apply to profit derived from export of (i) mineral oil, and (ii) minerals and ore.
- Up to the assessment year 1990-91 the deduction allowable is of the entire profit derived from export. For this purpose, the profit derived from export is to be computed as under:
 - If the assessee's turnover is from export only, the entire profit computed under the head "Profits and gains of business or profession" will be the profit derived from export.
 - If only part of the total turnover is from export the proportionate amount of profit computed under the head "Profit and gains of business and profession" will be the profit derived from export.

i) Domestic Sales	10,00,000
ii) Export Sales	20,00,000
-	30,00,000
	30,00,000

and the total profit under the business head is Rs. 3,00,000, the profit derived from export will be

$$3,00,000 \times \frac{20,00,000}{30,00,000} \text{ i.e., Rs. } 2,00,000$$

- With effect from the assessment year 1991-92, the amount of deduction depend upon the sale consideration brought in India. If the entire consideration for export turnover is brought into India in convertible foreign exchange within six months of the end of previous year or within such extended time as many be permitted by the Commissioner/Chief Commissioner, the entire profit computed in the manner described in Para 3 will be allowed as deduction.

If, however, only a part of the total consideration is brought in India, only the proportionate amount will be allowed as deduction.

Total Turnover shall not include:

- any sums receivable by an exporter by way of profit on sale of a license granted under the Imports (Control) Order 1955.
- Cash received or receivable against export under any scheme of the governments assistance.

iii) Repayment of any duty of customs for example:

Profit derived from export	2,00,000
(computed in the manner mentioned in para 3)	
Export turnover	20,00,000
Convertible foreign exchange brought in India	15,00,000

The deduction will be limited to

$$2,00,000 \times \frac{15,00,000}{20,00,000} = \text{Rs. } 1,50,000$$

5) This deduction is also available to a supporting manufacturer who, instead of making a direct export himself, exports through an Export House or Trading House. In this case the Export House or Trading House should issue a certificate of disclaimer that they have in respect of such export turnover not claimed the benefit of Section 80-HHC. The benefit available to the Export House/Trading House will in such cases be proportionately reduced.

Illustration 4 will help you to clearly understand the provisions Section 80-HHC.

Illustration 4

'A' supporting manufacturer exports through B, a Trading House, goods of Rs. 2,00,000. The total turnover of 'A' is Rs. 10,00,000 and the business profit is Rs. 1,00,000.

The total export turnover of the Trading House 'B' is Rs. 20,00,000 and business profit is Rs. 3,00,000. The entire sale proceed is brought into India in convertible foreign exchange. 'B' issues a certificate disclaiming the turnover of Rs. 2,00,000 of goods manufactured by 'A'.

Solution

Benefit available to 'A'	Rs.
Business Profit	1,00,000
Profit attributable to export $\frac{1,00,000 \times 2,00,000}{10,00,000}$	20,000
Deduction u/s 80-HHC	20,000
Benefit available to 'B'	
Business Profit	3,00,000
Less on account of disclaimer i.e.,	
$3,00,000 \times \frac{2,00,000 \text{ (disclaimed T/o)}}{20,00,000 \text{ (Total export T/o)}}$	30,000
Deduction u/s 80-HHC	<u>Rs. 2,70,000</u>

11.7.3 In Respect of Earnings of Tour Operators and Hotels (Sec. 80-HHD)

- 1) The following deduction is allowable to resident person engaged in the business of approved hotels, tour operators or travel agents in respect of profit derived from services provided to foreign tourists :
 - a) 50% of profit derived from services provided to foreign tourists, plus
 - b) so much of the remaining 50% as has been debited to Profit and Loss Account and credited to a reserve account.
- 2) The amount transferred to reserve account has necessarily to be utilised within next five years for following purposes:
 - a) construction of new approved hotels or expansion of facilities in existing approved hotels
 - b) purchase of new cars and new coaches
 - c) purchase of sports equipments for mountaineering etc.
 - d) construction of conference or convention centres
 - e) provision of such new facilities for growth of Indian tourism as may be notified by the Central Government.

For AY 1991-92 and onwards the amount brought in or received in Convertible Foreign Exchange (CFE) within 6 months from the end of PY will qualify for such deduction. It is further provided that the deduction will be restricted in the proportion as the receipt in CFE received in or brought in, if the reserve is utilised for any other purpose, it shall be deemed to be the profit of the year in which the amount was so utilised and shall be charged to tax. If the same remains unutilized in the next five years, the unutilized amount shall be deemed to be the profit of the sixth year and shall be charged to tax.

- 3) Profits derived from services provided to foreign tourists will be computed as under:
- a) In cases where the business consists exclusively of services to foreign tourists resulting in receipts in convertible foreign exchange, the entire profit computed under the head 'Profit and gains of business or profession'.
 - b) Where only part of the total activities consist of services to foreign tourists resulting in receipt of convertible foreign exchange, only that part of the business profit which is in proportion to such receipts and total receipts.

For example:

The total receipt of hotel	...	1,00,00,000
Receipts in convertible foreign exchange	...	25,00,000
Profit from business	...	20,00,000

The amount would be calculated as follows:

$$\text{The profit derived from services to foreign tourists will be } \frac{20,00,000 \times 25,00,000}{100,00,000}$$

i.e., 5,00,000

Presuming that no reserve is created. the deduction will be 50% of 5,00,000 i.e., 2,50,000.

For AY 1991-92 and onwards the amounts brought or received in convertible foreign exchange (CFE) within 6 month from end of PY will qualify for such deduction, It is further provided that the deduction is restricted in the proportion in which the receipts in CFE received or brought in India bears to the total receipt of the tourist carried on by the assessee.

11.7.4 In Respect of Remuneration of Teachers, Professors etc. (Sec. 80-R)

An Indian citizen deriving remuneration for services rendered outside India in the capacity as a professor, teacher or research worker in any University or other educational institution established outside India is entitled to following deductions:

Up to assessment year 1990-91 ... 50% of such remuneration for a maximum period of 36 months.

For and from assessment year 1991-92 ... 50% of remuneration or 75% of such remuneration as is actually brought into India, whichever is higher. The condition of 36 months is no longer applicable.

11.7.5 In Respect of Income Earned by Artists, Authors and Playwriters (Sec. 80-RR)

An Indian resident deriving income from outside India in exercise profession of an author, playwright, artist, musician, actor or sportsman (including an athlete) is entitled to deduction as under:

Up to assessment year 1990-91 ... 25% of such remuneration if the same was brought into India

For and from assessment year 1991-92 ... 50% of remuneration or 75% of such remuneration as is brought into India, whichever is higher.

11.7.6 in Respect of Income of Certain Technicians Rendering Services Abroad (Sec. 80-RRA)

- 1). An Indian citizen being a sponsored Central or State Government employee or a technician having specialised knowledge and experience in specified fields is entitled to deduction in respect of any remuneration from foreign sources.
- 2) The deduction will be of an amount equal to 50% of the gross remuneration or 75% of such remuneration as is brought into India, whichever is higher. Earlier such deduction is allowed for a maximum period of 36 months if the services were continuous but with effect from 1.4.91 this condition has been removed.
- 3) The deduction to persons other than the sponsored Central or State Government employees is allowed only if the terms and conditions of his services outside India are approved by the Central Government

11.8 DEDUCTIONS IN THE CASE OF TOTALLY BLIND OR PHYSICALLY HANDICAPPED RESIDENT PERSONS (SECTION 80-U)

A deduction of Rs. 15,000 is allowed to a resident individual who is—

- a) totally blind, or
- b) suffers from permanent physical disability specified in the rules which has the effect of substantially reducing his capacity to engage in gainful employment or occupation. or
- c) subject to mental retardation to the extent specified in rules and which substantially reduces his capacity to engage in gainful employment or occupation.

11.9 LET US SUM UP

The scheme of computing taxable income under the Income Tax Act is to first compute income under each head. The aggregate of income under each head is known as 'Gross Total Income'. Out of gross total income certain deductions are allowed which are not for expenses incidental to earning the income but are of the nature of incentives aimed at achieving certain socio-economic goals through the instrumentality of taxation or provisions to mitigate hardships to tax-payers who have necessarily to incur certain personal expenditure. Such deductions are laid down in Chapter VIA. The income after such deductions is called 'Total Income' which forms the basis for income tax.

These deductions are either income-based or expenditure-based. Income-based deductions are dependent upon and are in relation to income of specified nature. such as, deduction in respect of income from investments (80-L), income of poultry farming (80-jj), profit of newly established industrial undertakings (80-HH, 80-HHA and 80-I), profit from export of goods or merchandise (80-HHC), profit from services to foreign tourists (80-HHD), income earned for services rendered outside India (80-R, 80-RR and 80 RRA) and income of a totally blind or physically handicapped person (see 80-U). Expenditure-based deductions are based on and computed with reference to the expenditure investment of specified nature, viz., long-term savings (80-C), investment in new eligible equity issues (80-CC), deposit under National Savings Scheme (80-CCA), deposit under equity linked saving scheme (80-CCB), payment for medical insurance premia (80-D), payment as donation or contribution towards charity or purposes like scientific research, rural development and conservation of natural resources (80-G, 80-GGA), payment for rent (80-GG) and expenditure on treatment of handicapped dependents (80-DD).

One important point to remember is that the total of all deductions under Chapter VIA cannot exceed the Gross Total Income. In other words, these deductions cannot result in 'Total income' being a negative figure, i.e., loss.

11.1 KEY WORDS

Deductions: Permissible amount under Chapter VIA by which the gross total income is reduced to arrive at the total income liable to tax.

Gross Total Income: Aggregate of income computed under each head of income

Total Income: Amount of income computed in the manner laid down in the Income Tax Act on which tax is charged.

11.11 ANSWERS TO CHECK YOUR PROGRESS

- A) a) i) Rs. 10,000 (limited to 10%)
 ii) Rebate in tax—Rs. 2,000 (20% of Rs. 10,000)

b) i)	L.I.P.	3,000
	R.P.F.	24,000
	N.S.C.	10,000
	Home Loan Scheme	12,000
		49,000

Deduction for 1990-91 will be limited to the qualifying amount of Rs. 40,000 and will be calculated as under:

	6000	...	100%	=	Rs. 6,000
Next	6000	...	50%	=	Rs. 3,000
Balance	28000	...	40%	=	Rs. 11,200

- c) The qualifying amount of deduction will be Rs. 10,000 and deduction will be computed as under:

First	6000	...	100%	=	6000
Balance	4000	...	50%	=	2000
					8000

The taxable income will be 90,000 – 8,000, i.e. Rs. 82,000.

d)	Gross Total Income		Rs. 78,000
	Less deductions		
	U/s 80-C (100% of 2400)	2400	
	U/s 80-CC (50% of 20000)	10000	
	Total Income		Rs. 65,600

- B) a) i) Gross Total Income Rs. 80,000

	Less Deductions :				
	U/s 80-C L.I.P.	5000			
	Loan repaid (limited to)	10000			
	R.P.F.	6000			
		21000			
	6000	...	100%	-	6000
	6000	...	50%	-	3000
	9000	...	40%	-	3600
	U/s 80-CCA (100% of 9000)			-	9000
					12600
					Rs. 21,600
					Total Income for 1990-91 Rs. 58,400

- b) i) Rs. 10,000 will be included in the total income in the assessment for the year 1993-94.

- ii) There will be no tax-liability on the sum in respect of the amount withdrawn.

c) Gross Total Income.		Rs. 50,000
Less deductions :		
U/s 80-C — Int. on N.S.C. deemed to be reinvested	3000	
U/s 80-L i)	3000	
ii)	3000	
iii)	5000	
iv) limited to	<u>1000</u>	
	12000	Rs. 15,001
Total Income		<u>Rs. 35,000</u>

- C) a) 1 No
 2 No
 3 i) Yes
 ii) Yes
 iii) Yes
 iv) No
 4 i) Yes—Upto Rs. 3000 in the aggregate
 ii) Yes— -do-
 iii) Yes— -do-
 iv) No
 v) Yes—Up to Rs. 3000 in the aggregate
 vi) No
 5 i) Yes—Rs. 6000 irrespective of actual expenditure
 ii) No
 6 No
 7 i) No
 ii) No
 iii) No
- b) Rent paid in excess of 10% of Rs. 40,000 is Rs. 14,000. Deduction will be limited to Rs. 10,000 being 25% of the total income allowing such deduction.
- c) i) Yes—Rs. 6,000
 ii) The deduction will remain Rs. 6000 only for both.

- D) a) i) Rs. 5,000
 ii) Rs. 10,000
 iii) Rs. 5,000 (qualifying amount restricted to 10% of Rs. 50,000)
 iv) Rs. 2,500 -do-
 v) No deduction as the amount is less than Rs. 250
 vi) Rs. 1,250
- b) i) Rs. 1,000
 ii) Rs. 2,000
 iii) Rs. 3,000

No deduction will be allowed if income is derived from 'business or profession'. It will be allowed while computing income under that head.

c) Salary		Rs. 43,000
Other sources		<u>Rs. 8,000</u>
Gross total income		Rs. 51,000
Less deduction		
U/s 80-C—RPF	8,400	
6000 a 100%	6,000	
2400 a 50%	<u>1,200</u>	
U/s 80-CCA	7,200	
U/s 80-G	5,000	
U/s 80-L	350	
	<u>6,000</u>	18,550
Total Income		<u>32,450</u>

11.2 TERMINAL QUESTIONS/EXERCISES

Questions

- 1) What is gross total income? How do you compute it?

- 2) Distinguish between
 a) allowable expenses and deductions
 b) deductions and rebatc.

Exercises

- 1) 'X' a senior executive in Government has an income of Rs. 70,000 under the head 'Income from Salary'. He contributed Rs. 2000 per month to the statutory provident fund and purchased National Saving Certificates of Rs. 20,000. He has a son who is permanently handicapped. He contributed Rs. 2000 to the National Defence Fund.

How would you complete his assessment for the year 1990-91.

(Answer : Rs. 48,800)

- 2) 'X' is a Doctor who has an income of Rs. 1,20,000 from practise. During the previous year 1990-91 he deposited Rs. 30,000 under the National Savings Scheme and contributed Rs. 12,000 to the Public Provident Fund. He is living in a rented house for which he pays rent of Rs. 3000 per month.

Work out his total income for the assessment year 1990-91.

(Answer : Rs. 69,800)

- 3) 'X' has following income from his investment:
- | | |
|---|------|
| i) Income from Units of Unit Trust of India | 3000 |
| ii) Income from Units of State Bank Mutual Fund | 2000 |
| iii) Interest from bank? | 3500 |
| iv) Interest from National Savings Certificate | 4500 |
| v) Dividend from Indian companies | 2000 |
| vi) Interest on debentures of DCM Ltd. | 1000 |

Find out the total income for 1990-91 if his income from business is Rs. 80,000 including Rs. 10,000 profit derived from export.

(Answer : Rs. 58,000)

- 4) 'X' has several business profit from which is as under:
- | | |
|---|----------|
| i) Retail cloth business | 15,000 |
| ii) Poultry farming | 45,000 |
| iii) New industrial unit which began to manufacture articles in June 1990 | 60,000 |
| | 1,20,000 |

He made a donation of Rs. 20,000 to a hospital income of which is exempt under Section 10(22A).

Work out his total income for the assessment year 1990-91.

(Answer : Rs. 84,750)

- 5) 'X' who suffers from a permanent physical disability (which has the effect of reducing substantially his capacity to engage in a gainful employment) derives following income:

Pension	...	36,000
Interest from Bank	...	14,000
		50,000

He contributed Rs. 6000 to Public Provident Fund. Find out his total income for 1990-91.

(Answer : Rs. 23,000)

- 6) 'X' who is a citizen of India is employed as a professor in an University in USA and draw a remuneration in US \$ which is equivalent to Rs. 4,00,000 in Indian rupee. He remitted an amount equivalent to Rs. 3,00,000 to India during the previous year 1990-91.

Find out his total income for the assessment year 1990-91.

(Answer : Rs. 2,00,000)

Note : These questions will help you to understand the unit better. Try to write answers for them, But do not submit your answers to the University. These are for your practice only.

UNIT 12 COMPUTATION OF TOTAL INCOME

Structure

- 12.0 Objectives
- 12.1 Introduction
- 12.2 Steps in Computation of Total Income
- 12.3 **Headwise** Computation of Income
- 12.4 Computation of Gross Total Income
- 12.5 Deductions Under Chapter VIA
- 12.6 Some Illustrations
- 12.7 Let Us Sum Up
- 12.8 Terminal **Questions/Exercises**

12.0 OBJECTIVES

After studying this unit you should be able to:

- compute income under individual heads;
- compute Gross Total Income;
- calculate the losses to be set off and carried forward and set off in succeeding years, and finally;
- compute the total income.

12.1 INTRODUCTION

You know the **assessee** is put to tax on the basis of his residential status. Income tax is chargeable on the 'total income' of the previous year at the rate prescribed in the Annual Finance Act for the assessment year relevant to that previous year. 'Total income' is defined as the income computed under the provisions of Income Tax Act, 1961. The same forms the basis for computing the tax payable by or refundable to the assessee. In this unit you will study how the income from different heads is computed, what deductions are allowed and how the income chargeable to tax calculated.

12.2 STEPS IN COMPUTATION OF TOTAL INCOME

The following stages are involved in the computation of total **income**:

- i) Computation of taxable income from each source under a **particular** head;
- ii) Computation of taxable income under each head;
- iii) Computation of gross total income;
- iv) Ascertaining the amount of deductions admissible under Chapter **VIA**; and
- v) Arriving at the Total Income.

12.3 HEADWISE COMPUTATION OF INCOME

Under the scheme of Indian Income **Tax** Act, the income of a tax-payer falls in one or more of the following heads of **income** :

- Income from salaries
- Income from house property
- Profits and gains of business or profession
- Income from capital gains
- Income from other sources.

Specific provisions are contained in the Act for computation of income under each head of income. As a broad general **principle**, in the absence of any specific mention of allowances or disallowances, income under each head is computed by deducting from the gross **profit/receipts** the expenses of revenue nature which are incidental to business (Section 37) in case of business income and which are incidental to earning **the** income in other cases.

(For detailed discussion refer to Units 5 to 10).

Income **from** different sources under each 'head of income' is to be separately computed. For example, a person may be the owner of more than one business in **which** case, the profit of each business will **be** computed separately **and** total of all will be the income under the head 'profits and gains from business or profession'. Similarly, a person may earn capital gains from more than one transaction in which **case** gains arising from each transfer is to be separately computed and the total of such gains will come under the head 'Capital gains'.

If there is income from one source and loss from another source falling within the same head of income the loss will be adjusted (technically known as set off) against **the income** of another source and only the net figure will be the income under the head. If, for example, there is profit of Rs. 50,000 from business 'A' and loss of Rs. 30,000 from business 'B', it is only Rs. 20,000 after such intra-head adjustment that will be 'profit from business'.

Speculation loss is, however, allowed to be set off only out of profit from another speculation business **and** not from the profit of any other business.

12.4 COMPUTATION OF GROSS TOTAL INCOME

Having computed income under individual heads (refer 12.4 above), the next step is the aggregation of income under all the heads.

If the income computed under any head or heads is a loss, such loss is allowed to be adjusted against the income under other heads. For example, if the computation under the head 'Profit and **gain** of business' is a profit of Rs. 1,00,000 and there is a loss of Rs. 30,000 under the head '**income** from house property' the loss **can** be adjusted against the business income with the result that there will be profit from business Rs. 70,000 only.

As mentioned in Para 5 of 12.3, the loss arising from speculation business cannot be set off **either** out of profit of any other business or income under any **other** head.

After the inter-head set off mentioned in Para 1 above, the next step is to **allow** set off of the past losses under business and capital gains which could not be set off in earlier years and hence carried forward in those years. Such a set off is, however, subject to the following conditions:

- loss carried forward can be set off against income under the same head, if any.
- carried forward speculation loss can be set off against speculation profits only.
- business loss can be set off against the business income only if the same business is not **discontinued**.
- loss under the head business can be carried forward to eight succeeding assessment years only but unabsorbed depreciation can be carried forward without any limitation as to time. Thus, if the loss is carried for an assessment year beyond eight years, no set off is permitted.
- loss arising from long-term capital gain can be carried forward to eight succeeding assessment years for set off against income under the head 'capital gains' only.

In the above example if there was a carried forward business loss of **Rs. 60,000**, it will be set off **against** business income of Rs. 70,000 thus reducing the income under this head is Rs. 10,000 only.

In case the carried forward business loss was Rs. 70,000 the entire loss would have been resulted **in** nil income under the business head. If the carried **forward** business loss was Rs. 80,000, it would have been set off to the extent of Rs. 70,000 and the

remaining loss of Rs. 10,000 carried forward for set off in succeeding years. This presumes that the same business is still continued in this year and the carried forward loss is not more than eight years old.

The income of each head after inter-head set off and set off of carried forward losses mentioned in Paras 2 and 3 is then aggregated to give Gross Total Income.

12.5 DEDUCTIONS UNDER CHAPTER VIA

Next step for calculation of taxable income is the deduction. The Gross Total Income is reduced by the deductions mentioned in Chapter VIA. It is important to note that such deductions cannot exceed the Gross Total Income. For detailed discussion of such deductions refer to Unit 11.

After the deductions are made the resulting figure is total income which is subjected to tax at the rate or rates mentioned in the Finance Act.

12.6 SOME ILLUSTRATIONS

Let us now study a few illustrations for clear understanding of computation of total taxable income of an individual.

Illustration

The detail of X's income during the previous year 1989-90 are as under:

- 1) Salary from a public limited company Rs. 7,000 per month. In addition he was in receipt of conveyance allowance of Rs. 1,000 per month which is claimed to be totally spent for the purpose. He was also allowed free use of a car (16 RP) owned by the employer.
- 2) He owned two properties —
 - i) Property 'A' was a commercial one let out at Rs. 2,000 per month. He paid Rs. 6,000 as municipal taxes for this property, spent Rs. 600 for collecting rent and Rs. 6,000 as interest on the amount borrowed for construction.
 - ii) Property 'B' was a residential unit construction of which was completed in the year 1988. It was let out at Rs. 1,500 per month. Municipal taxes were Rs. 3,500. He incurred expenditure on repairs Rs. 500 and paid Rs. 8,000 as interest on the amount borrowed for construction.

Calculate his' income under the relevant heads and the Gross Total Income for the year 1990-91.

Solution

	Rs.	Rs.
Salary—B'asic	84,000	
Perquisite value of car 300×12	3,600	
	87,600	
Less standard deduction	12,000	
	75,600	75,600
Income from Properties		
	Rs.	
A) Rental value	24,000	
Less : Taxes	6,000	
	18,000	
	A L V	
Less : 1/6 for		
Repairs	3,000	
Interest	6,000	

Collection Charges (being less than 6%)	<u>600</u>	9,600	8,400	
B) Rental value		18,000		
Less : taxes		<u>3,000</u>		
		15,000		
Less : for new unit		<u>3,600</u>		
	A L V	11,400		
Less : 1/6% for Repair	1,900			
Interest	<u>8,000</u>			
		<u>9,900</u>	<u>1,500</u>	<u>9,900</u>
			Gross Total Income	<u>85,500</u>

Illustration 2

'X' is a government employee getting a basic salary of Rs. 3,500 and D.A. Rs. 1,400 per month: He is allotted a government accommodation for his residence the market rent of which is Rs. 1,500 per month but he is charged Rs. 100 per month only.

During the year he purchased 1000 units of the Unit Trust of India at Rs. 13, got a dividend of Rs. 1,800 and sold them at Rs. 10 per unit. He also purchased 500 Reliance Shares at Rs. 150 and sold them at Rs. 250 per share.

He has an ancestral house property which is used by his family for self-residence.

Compute the income under relevant heads for the assessment year 1990-91.

Solution

		Rs.	Rs.
Salary — Basic		42,000	
D.A.		16,800	
Perquisite value of House		nil	
		<u>58,800</u>	
Less : standard deduction		<u>12,000</u>	46,800
Property — There is no Annual Value for self-occupied property			nil
Other sources — Dividend from UTI			1,800
Capital Gains — Short-term capital gains			
Loss on Units of UTI	(-)	3,000	
Gain on Reliance shares		<u>5,000</u>	<u>2,000</u>
		Gross Total Income	<u>50,600</u>

Illustration 3

'X' is a professor in a college getting Rs. 4,500 per month as basic salary. He earned Rs. 3,500 from examinership. He had purchased 200 shares in 1987 at Rs. 90 per share which he disposed of at Rs. 50 during the year. He also earned a short-term capital gain of Rs. 13,000 in another transaction of shares.

He also indulged in forward trading of ACC shares in which he incurred a loss of Rs. 7,000.

He has an old residential property in Alwar, — his home town which he has neither let out nor is he occupying it by reason of his employment in Delhi. The fair rental value of the property is Rs. 600 per month. He paid Rs. 1,200 as Municipal Tax and Rs. 1,000 as interest on money borrowed for improvements made in the property in 1987.

Work out the income under relevant heads for the assessment year 1990-91.

Solution

	Rs.	Rs.
Salary-Basic	54,000	
Less standard deduction	<u>12,000</u>	
Business — Speculation in share		32,000
Other sources — Examinership		(-) 7,000
Capital Gains		3,500
Long-term loss on share	(-) 8,000	
Less deduction u/s 48(2)	<u>8,000</u>	
	nil	
short-term gain on shares	<u>13,000</u>	<u>13,000</u>
	Gross Total Income	58,500

- N.B.—** 1) The Annual Value of property of this type is Nil and there can be no loss computed in respect of such properties (Sec. 23(3)).
- 2) The speculation loss can be set off duly against speculation profit. Hence not deducted in working out Gross Total Income.

Illustration 4

'X' is a salaried employee in a private sector enterprise in Delhi getting Rs. 4,000 per month. He was also provided with a free furnished residence which was hired by the employer at Rs. 3,000 per month. The cost of furnishing was Rs. 50,000. In addition he was allowed free the services of a watchman, a gardener and a sweeper who were paid Rs. 2,400, 2,400 and 1,800 per year respectively by the employer.

He earned a capital gain (short-term) of Rs. 10,000 from sale of a plot of land, In 1985 he had incurred a short-term capital loss, out of which Rs. 6,000 was carried forward.

Find his Gross Total Income.

Solution

	Rs.	Rs.
Salary	48,000	
Perquisite value of house	17,000	
Perquisite value of Watchman	2,400	
Perquisite value of Gardener	2,400	
Perquisite value of Sweeper	<u>1,800</u>	
	71,600	
Less standard deduction	<u>12,000</u>	59,600
Income from Business or Profession		
Consultancy charges		25,000
Capital Gains		
Short-term	10,000	
Less set off of carried forward loss	<u>6,000</u>	4,000
	Gross Total Income	88,600

Illustration 5

The following are the particulars of income of 'X':

- 1) He is employed in a public sector undertaking on a salary of Rs. 10,000 per month.
- 2) He was allowed arrears of salary amounting to Rs. 20,000 which relates to the past two years.

- 3) During the year he availed of leave travel concession for going to Goa and Second Class AC fare amounting to Rs. 5,600 was reimbursed by the employer for him and his family.
- 4) He was paid Rs. 4,000 as premium on medical.
- 5) He paid profession tax to the State Government amounting to Rs. 1,000.
- 6) He is insured for Rs. 50,000 and pays a life insurance premium of Rs. 7,000 per annum.
- 7) He contributed Rs. 3,000 per month to the Provident Fund.

Work out the total income for the assessment year 1990-91. What would have been the position of the above details were for assessment year 1991-92.

Solution

	Rs.	Rs.
Salary—Basic	1,20,000	
Arrears	30,000	
Medical Ins. Premium	4,000	
	1,44,000	
Less standard deduction	12,000	
Less Profession tax	1,000	
	13,000	
		1,31,000
	Gross Total Income	1,31,000
Less deductions		
U/S 80-D	3,000	
UIS 80-C		
LIP 5,000		
PF 36,000		
	41,000 restricted to 40,000	
First 6000 — 100%	6,000	
Next 6000 — 50%	3,000	
Next 28000 — 40%	11,200	
	20,200	23,200
	Total Income	1,07,800

Assessment Year 1991-92

		Rs.
Gross total income as worked above		1,31,000
Less deduction uls 80-D		3,000
		1,28,000
	Total Income	1,28,000

Tax will be calculated on Rs. 1,28,000. Out of the tax so calculated, rebate of Rs. 8,200 (20% of 41,000) will be allowed.

N.B. The assessee could have claimed relief under Section 89 in respect of arrears of salary.

Illustration 6

Mr. 'Y' who was an employee with a private sector enterprise on a monthly salary of Rs. 7,500 plus dearness allowance of Rs. 1,500 retired after 20 years of completed service on 31st August, 1989 and received the following amount on retirement.

- i) a) Accumulated balance in Recognised Provident Fund including employer's contribution and interest thereon Rs. 3,60,000.
- b) Encashment of four months accumulated leave Rs. 30,000.

- c) Gratuity amounting to Rs. 1,00,000.
- ii) He owned a residential property which was constructed in May 1987: The same was let out at Rs. 4,000 per month. He paid Rs. 12,000 as municipal taxes and spent Rs. 3,000 on collection of rent.
- iii) During the year he deposited Rs. 20,000 under the National Saving Scheme of the Government of India.
- iv) He has a handicapped son and spent Rs. 10,000 on his medical treatment.
- v) He made the following donations during the year —
 National Defence Fund Rs. 5,000
 Bombay Hospital Rs. 10,000
- Find out his total income for the assessment year 1991-92.

Solution

Basic (Apr.-Aug.)			37,500	
D.A. (Apr.-Aug.)			7,500	
Gratuity	1,00,000			
Lessexempt — 112 months salary for 20 years 7500×10	<u>75,000</u>			
			<u>25,000</u>	
			<u>70,000</u>	
Less standard deduction			<u>12,000</u>	58,000
Income from House Property				
		Rs.	Rs.	
Rental value		48,000		
Less Tax		<u>12,000</u>		
		36,000		
Less for new construction		<u>3,600</u>		
ALV			32,400	
Less 1/6 for repairs 5400	5400			
Less collection charges (Ltd. to 6%) <u>1944</u>	<u>1944</u>		<u>7,344</u>	25,056
			Gross Total Income	<u>83,056</u>
Less deductions				
U/S 80-CCA — deposit under NSS			20,000	
U/S 80-DD — exp, on handicapped son'			6,000	
U/S 80-G —donation N.D.F. Bombay Hospital 2500				
(Qualifying amount restricted to 10% of 83056 — ,26000, i.e., 5706) <u>2,853</u>			<u>5,353</u>	<u>31,353</u>
			Total Income	<u>51,703</u>
			Rounded off to	51,700

Illustration 7

The proprietor of Amrit Kirana Store has a profit of Rs. 13,800 from business. He is owner of several properties, the details of which are given below:

- i) Property 'A' is a shop which is let out at Rs. 2,000 per month. Municipal tax paid . Rs. 4,000.
- ii) Property 'B' is residential unit construction in 1987 let out at Rs. 3,000 per month. Municipal taxes paid Rs. 12,000, The property remained vacant in the last three months.
- iii) Property 'C' is self-occupied constructed in April, 1988, municipal assessment of this property is Rs. 25,000 per month. Taxes paid are Rs. 10,000. Interest payable on amount borrowed for construction is Rs. 7,000.

During the year part re-payment of Rs. 15,000 was made to the Bank towards loan taken for property 'B'.

He contributed Rs. 1,000 per month to the Public Provident Fund. He also contributed Rs. 5,000 towards 'Jiwan Dhara' annuity policy of LIC.

He made a donation of Rs. 5,001 to the National Children's Fund.

Find out his total income for the assessment year 1990-91. What will be the total income if the above details relate to assessment year 1991-92.

Solution

Income from properties

	Rs.	Rs.	Rs.
Prop. A— Rental value	24,000		
Less tax	<u>4,000</u>		
	20,000		
Less 1/6 for repairs	<u>3,333</u>	16,667	
Prop. B— Rental value	36,000		
Less tax paid	<u>12,000</u>		
	24,000		
Less for new unit	<u>3,600</u>		
	20,400		
	ALV		
Less 1/6 for repair	3,400		
Less vacancy allowance 3/12 of 20400	<u>5,100</u>	11,900	
	8,500		
Prop. C — Annual Value	Nil		
Less interest	<u>(-)5,000</u>	<u>(-)5,000</u>	23,567
Income from business			
Profit from Amrit Kirana			<u>13,800</u>
		Gross Total Income	<u>37,367</u>
Less deduction			
U/S 80-C —Refund of Loan	10,000		
P.P.F.	<u>12,000</u>		
	22,000		
	<u>4000 — 100% ... 6,000</u>		
	<u>6000 — 50% ... 3,000</u>		
	<u>10000 — 40% ... 4,000</u>	13,000	13,000
U/S 80-CCA — Contribution to Jiwan Dhara			5,000
U/S 80-G — 50% of 5001			<u>2,500</u>
			<u>20,500</u>
			<u>16,867</u>
			(Rounded, off to 16,870)

For assessment year **1991-92**

Gross total income	37,367
Less deduction	
U/S 80-CC A	5,000
U/S 80-G	<u>2,500</u>
	<u>7,500</u>
	<u>29,867</u>
	(Rounded off to 29,870)

N.B. — Tax will be computed on 29870 and a rebate up to an amount equal to 20% of 22,000, i.e., Rs. 4,400 will be allowed. Since the tax on Rs. 29,870 will be less than Rs. 4,400, no tax will be payable neither any refund will be allowed.

Illustration 8

A has following investments:

i) Fixed deposit of Rs. 50,000 @ 11% in a bank.

- ii) 1000 Units of UTI of Rs. 10 each. Dividend declared 18%.
- iii) Fixed deposit of Rs. 1,00,000 with D.C.M. Ltd. at 14% per annum.
- iv) Deposit of Rs. 50,000 under National Saving Scheme yielding interest at 11%.
- v) National Savings Certificate VI Issue of the face value of Rs. 90,000 purchased in earlier years. Interest accrued during the year Rs. 14,000.
- vi) 2000 shares of G.E. Shipping of Rs. 10 each. Dividend declared 20%.

Find his total income for the year 1991-92.

Solution

Income from other sources

Int. on F.D. in Bank	5500	
Int. on F.D. with DCM	14000	
Int. on NSC	14000	
Div. from UTI	1800	
Div. from G.E. Shipping	4000	
Gross Total Income		39,300
Less deduction u/s 80-L		
7000 + 1800 + 3000		11,800
		<hr/>
Total Income		27,500
		<hr/>

N.B. — Rebate of an amount equal to 20% of Rs. 14,000 (accumulated interest on N.S.C. VI issue) will be allowed u/s 88 out of the tax computed on the above total income. Since the tax on 27500 is less than Rs. 2800, there will be neither any tax payable nor refund allowable to the assessee.

12.7 LET US SUM UP

The assessee pays tax on his total income. This total income is nothing but the aggregate of taxable income from each head i.e., salaries, house property, business and profession, capital gains and income from other source.

From this aggregate income the carried forward losses are set off and the permissible deductions u/s 80 are allowed. The resulting figure is the taxable income of the assessee.

12.8 TERMINAL QUESTIONS/EXERCISES

Questions

- 1) What steps are involved in calculation of total taxable income of an individual?

Exercises

- 1) 'X' is employed with ABC (P) Ltd., Delhi on a monthly salary of Rs. 4,600 and D.A. Rs. 1,400. He has been provided with a free unfurnished residence belonging to employer and also the services of a gardener. He is entitled to free medical treatment in a dispensary maintained by the Company and free refreshment during working hours. He also gets conveyance allowance of Rs. 1,000 per month which he claims to spend for company's work.

He contributes Rs. 2,000 per month to a recognized provident fund. During the year, he purchased National Savings Certificate VIII issue of Rs. 5,000. He has a handicapped son whose capacity to be engaged in gainful employment is substantially affected.

Find out his total income for the assessment year 1990-91 and the tax rebate admissible to him.

(Answer: Salary income Rs. 65,520. total income Rs. 54,900).

- 2) 'X' is the owner of several properties the details of which are given below:
- i) Property A — constructed in 1987 — used for self-residence — Municipal rental value Rs. 4,000 per month — Municipal tax paid Rs. 10,000 — Interest paid on money borrowed for construction Rs. 12,000.
 - ii) Property B — Ancestral — Let out at Rs. 2,000 per month for residential purpose — Municipal rental value Rs. 1,000 per month — Tax paid Rs. 2,000 — Insurance premium Rs. 2,000.
 - iii) Property C — Office premises — Constructed in 1988 — Let out at Rs. 5,000 per month. Taxes paid Rs. 15,000 — Interest paid on money borrowed for construction Rs. 40,000. Property remained vacant for last two months.

He contributed Rs. 2,000 per month to the Public Provident Fund and deposited Rs. 20,000 under the National Savings Scheme. He made a donation of Rs. 5,000 to the National Defence Fund.

Work out his total income for 1990-91 and the tax rebate admissible to him.

(Answer: Income from house property Rs. 1,333).

- 3) 'X' is employed in a public sector undertaking on salary of Rs. 7,000 and a dearness allowance of Rs. 1,000 per month. He was provided with a rent free accommodation (hired by the employer at 4,500 per month), free use of furniture costing Rs. 1,00,000, free gas and electricity and free use of a chauffeur driven ambassador car.

He had a deposit of Rs. 1,00,000 in the bank at 11%, shares of the face value of 50,000 on which 15% dividend was declared, Units of UTI of the value of Rs. 70,000 on which 18% dividend was declared and NSCs purchased two years back on which interest of Rs. 11,000 accrued.

He invested Rs. 30,000 in the purchase of shares which formed part of the new eligible issue of a manufacturing company.

Work out his total income for 1990-91 and 1991-92 (presuming that the facts remain the same) as also the tax rebate admissible for 1990-91.

(Answer: Taxable income Rs. 76,300 for 1990-91 and Rs. 84,800 for 1991-92).

- 4) 'X' is a 40% partner in a firm where his share was determined at 1,12,000. He also runs a poultry farm from where a profit of Rs. 66,000 accrued. He is living in a rented house paying Rs. 4,000 per month as rent. He contributed Rs. 10,000 towards the 'Jiwan Dhara' annuity plan of the LIC and deposited Rs. 35,000 under the National Savings Scheme. He also purchased NSCs VIII issue of the value of Rs. 10,000. Find out the total income for the assessment year 1990-91 and on the same facts for 1991-92 as also the tax rebate admissible for 1990-91. (Answer: Taxable income for 1990-91 Rs. 1,06,000 and for 1991-92 Rs. 1,04,000)

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

UNIT 13 FILING OF RETURN AND TAX AUTHORITIES

Structure

- 13.0 Objectives
- 13.1 Introduction
- 13.2 Return of Income
 - 13.2.1 Selection of Correct Form of Return
 - 13.2.2 Due Dates for Filing the Return
 - 13.2.3 Correct and Complete Information
- 13.3 Self-assessment
- 13.4 Consequences of Delay in Filing Return
- 13.5 Consequences of Incorrect Information
- 13.6 Processing of Returns
- 13.7 Re-assessment of Income
- 13.8 Tax Authorities
- 13.9 Let Us Sum Up
- 13.10 Key Words
- 13.11 Answers to Check Your Progress
- 13.12 Terminal Questions

13.0 OBJECTIVES

After studying this Unit you **should** be able to:

- select the forms of return and due dates for filing return;
- list the information to be provided in the return;
- make self-assessment of your income and define, deduct tax at source and advance tax;
- **enumerate** the consequences of delay in filing the return and incorrect information;
- list the steps of processing of returns;
- enumerate the reasons for reassessment of income; and
- list the tax-authorities and their functions.

13.1 INTRODUCTION

In the **previous unit** you have **studied** about the **computation** of total income as per the provision of Income Tax Act 1961. After the income has been computed, the next **step** is to **inform** the tax authorities about the taxable income and pay tax. In this unit you will study how the return is filed with the tax authorities and how the return is processed. You will also study about the tax authorities and **their** function.

13.2 RETURN OF INCOME

For quantification of tax liability every person whose total income exceeds the exemption limit (which for and from the assessment year 1991-92 is Rs. 22,000) is **required** to file a statement of his total income technically called 'return of income' within the prescribed time to the prescribed income tax authority. This return forms the basis for determining the total **income** and arriving at the tax payable or refundable to the assessee. After receipt of the return, the tax authorities may **decide** to accept the information furnished therein **as true** and calculate the tax liability based on such information only. In other cases they may call upon the tax-payer to substantiate the information and evidence to satisfy the authorities about the correctness and completeness of the **information supplied** in the return. They may themselves make independent enquiries, ask questions from the tax-payer and seek such further information **as may** be considered necessary for determination of correct assessable income. The **total** income is then determined after **making such** modification in the income stated in the return as may be warranted by the evidence furnished by the tax-payer and enquiries made by the tax authorities.

Filing of the Return of Income every year is the first step in the proceedings for completion of assessment and determination of tax liability. It is an important document which needs to be filled in very carefully and accurately.

Furnishing of inaccurate information or omission to disclose any material information may entail penal consequences and may even subject the tax-payer to the risk of criminal prosecution. It is, therefore, necessary to know about it in some details.

13.2.1 Selection of Correct Form of Return

There are four types of income-tax returns.

One of these returns is relevant for an assessee and the relevance is determined by the status (company or other) of the assessee and by the sources from which income is derived by him. These are :

- 1) Form No. 1 — For companies (except those claiming exemption under Section 11 in respect of income from property held for charitable and religious purposes).
- 2) Form No. 2 — For assesseees (other than companies and those claiming exemption under Section 11) deriving income from business or profession,
- 3) Form No. 3 — For assesseees (Other than companies and those claiming exemption under Section 11) not deriving income from business or professions.
- 4) Form No. 3A — For assesseees including companies claiming exemption under Section 11 in respect of income from property held for charitable and religious purposes.

These returns are available in the income-tax offices free of charge.

13.2.2 Due Dates for Filing the Return

The last dates for filing the return of income with the tax authority having jurisdiction over an assessee's case are laid down in Section 139(1) of the Income Tax Act and determined by the status (company or others) of the assessee, sources of income (whether from business or profession or from sources other than 'business or profession') and whether the accounts are required to be audited under any provision of the Income Tax Act or any other law. The due dates are—

Type of assessee	Date in the assessment year
i) Assesseees (Other than companies) not deriving income from business or profession and in respect of whose accounts where is no legal requirement for getting the accounts audited.	30th June
ii) Assesseees (Other than companies) deriving income from business or profession, in respect of which there is no legal requirement of getting the accounts audited.	31st August
iii) Assesseees (Other than companies) accounts of which are required to be audited under the I.T. Act or any other law. Under the I.T. Act accounts of a business are required to be compulsorily audited if the total sales, turnover or gross receipt exceeds 40 lakhs rupees. Accounts of persons carrying on profession are required to be audited if the gross receipts exceed 10 lakh rupees. A charitable trust having income of more than Rs. 25,000 is also required to get its accounts audited.	31st October
iv) Companies	31st December

If the assessee is a partner in any firm, the due date of filing the return will be the same which is the due date for the firm in which he is the partner..

Under the Income Tax Act if the income of an assessee exceeds the exemption limit he should file a return of income before the due date applicable to him.

If, however, for any reason he is not able to do so, he can still file the return after the due date but before the expiry of one year from the end of the relevant assessment

year or before the completion of assessment whichever is earlier. If, for example, the assessee is a person not deriving income from business and accounts are not required to be audited under any law, he is supposed to file the return by 30th June of the assessment year. For income earned in the previous year 1989-90 (i.e., from April 1 1989 to March 31, 1990) the relevant assessment year will be 1990-91 and the return will be due on June 30, 1990. If for any reason he has not been able to file the return by June 30, 1990 he can file the return thereafter but in any case the return should be filed before the expiry of one year from the end of 1990-91 i.e. before one year from March 31, 1991. This means that the return should be filed by March 31, 1991 but if, in the meantime, an *ex parte* assessment has already been completed for failure to file the return say on September 15, 1991, the right to file the return will lapse on September 15, 1991. Please remember that although the assessee can file the return even after the due date, this will be subject to an interest at the rate of 2% per month for the period calculated from the due date to the date of actual filing.

If the return is not filed, the assessing officer can, acting under Section 142(1), serve the assessee with a notice after the expiry of the due date asking him to file the return within the time specified in the notice.

If after filing the return the assessee discover any omission or any wrong statement therein, he can furnish a revised return anytime before the expiry of one year from the end of the relevant assessment year. If, however, an assessment has been completed in the meantime, the right to file the revised return will lapse.

Check Your Progress A

Which is the return form for you and when is it due for submission?

- i) If you derive income from salary and interest on investments.
- ii) If you derive income from salary and also share income from a firm which does not get its accounts audited.
- iii) If you run a business total turnover of which is Rs. 50 lakhs.
- iv) If you are a Chartered Accountant and your annual receipts are 5 lakhs.
- v) If you are a private limited company with turnover of one lakh only.
- vi) If you are a trust deriving income from property held in trust for the education of poor having income of Rs. 30,000.

13.2.3 Correct and Complete Information

The information furnished in the return is required to be verified at the end in order to be sure that it is true and correct. The verification is an affirmation and if it is found to be false, one is subject to severe consequences including prosecution. Apart from being correct, it is necessary that the return is complete in all respects. Nothing which has a bearing on the computation of correct assessable income should be suppressed i.e. every information which affects the assessable income directly or indirectly should be disclosed. Wherever possible, necessary evidence should be enclosed with the return. To illustrate the assessee should attach the following documents to substantiate the information under different heads:

Salaries

- a) The employer's certificate giving details of remuneration.
- b) The employer's certificate showing tax deducted at source.

House Properties

- a) A statement showing how the income shown in the return has been arrived at.
- b) Details of interest payment.

Business and Profession

- A) In cases where regular accounts are maintained:
 - a) Copy of Trading/Manufacturing Account.
 - b) Copy of Profit and Loss Account
 - c) Copy of Balance Sheet
 - d) Details of depreciation claimed
 - e) Auditor's report, if accounts are audited
 - f) Details of payment for txcs etc. which are allowed on cash basis only.
- B) In cases where regular accounts are not maintained:
 - a) Statement showing how the income has been arrived at
 - b) Details of depreciation claimed.

Other Sources

- a) In case of **income from dividend**—the dividend warrants.
- b) In case of **income from interest**—interest warrants or details of **interest earned along** with certificate of tax deducted at source, if any.
- c) In case of income from any other source like royalty, winning from lotteries, income from sub-letting etc.—**necessary details thereof along** with the certificate of tax deduction, if any.

Capital Gains

- a) Details of capital gains derived giving the computation of such gains.
- b) Evidence of re-investment of capital **gain/sale** proceed as a result of **which** capital gain is not to be fully or partially charged to tax.
- c) Evidence of deposit in specified bank account under **the** notified scheme.

In All Cases

- a) Evidence in respect of deductions claimed under Chapter VIA, e.g.;

U/S 80C/88	...	Life Insurance receipts, receipts for deposit in Public Provident Fund, details of NSCs purchased etc.
U/S 80CC/88A	...	Details of investment in eligible issues of capital or in relevant schemes of mutual funds.
U/S 80CCS/80CCB	...	Details of deposit under National Saving Scheme or notified annual plans or investment under notified equity linked saving scheme.
U/S 80D	...	Medical insurance receipt.
U/S 80DD	...	Certificate from competent doctor regarding permanent physical disability.
U/S 80G/GGA	...	Receipts for donations/contributions made.
U/S 80GG	...	Receipts for rent payment .
U/S 80R & 80RR & 80RRA	...	Evidence of remuneration etc. in foreign currency and evidence of money brought in the country. In case of deduction under Section 80RRA, copy of approval of the agreement should be enclosed.

An assessee is identified in the Income Tax Department by the Permanent Account Number (PAN) allotted to him. Under Section 139A if the total income of an assessee exceeds the exemption limit (which is Rs. 22,000 for and from the assessment year 1991-92) and he has not already been allotted a PAN, he should apply to his assessing officer for allotment of PAN.

This number should be clearly mentioned in the **Return** form and all correspondence with the department. Earlier the tax-payers were identified by the General Index Register number (GIR No.) and in the transitional period both the numbers are in use till GIR is completely replaced by PAN.

13.3 SELF ASSESSMENT

Although the income of the financial year (technically called 'Previous Year') is finally assessable for the next financial year (technically called 'assessment year'), the Income tax Act contains provisions for collection of tax in the previous year itself. Such collection is provisional in nature in the sense that the same is considered to have been paid towards the final liability to be determined on the basis of return or on completion of assessment for the relevant assessment year. Accordingly whatever taxes are paid by the assessee under these provisions are **adjusted against** the tax finally determined and the balance amount is payable by or refundable to the tax-payer.

Tax is collected in the previous year itself by either or both of the following methods :

- i) **Tax deduction at Source (T.D.S.)** — This system requires the person making payment for salaries, interest on securities, interest other than interest on securities, insurance **commission**, dividend, winnings from lotteries or horse races

etc. or those making payments to contractors for work executed by them or to non-residents, to deduct tax at prescribed rates and to pay the net amount only. The tax so deducted is to be deposited with the Government which is considered as the tax paid by the recipient for which credit is to be allowed to him in the final determination. For example, if an assessee earns an interest of Rs. 10,000 from A, the payer, i.e. A will, at the time of payment or credit to the assessee's account, deduct tax at the prescribed rate of 10% and pay only Rs. 9,000 to him. He will deposit this Rs. 1,000 with the Government and issue a certificate to the assessee. The assessee will include an income of Rs. 10,000 from interest in his total income. Suppose his total income including this interest is Rs. 50,000 on which tax works out to Rs. 7,600, the tax payable by him will be Rs. 7,600 minus Rs. 1,000 tax already paid by way of deduction and the balance of Rs. 6,600 only will be required to be paid. In the said example if the total income is Rs. 25,000, the tax will work out to Rs. 600 only and since Rs. 1,000 has already been paid as TDS, the assessee will be entitled to a refund of Rs. 400.

- ii) **Advance Tax** : If an assessee derives income from sources in respect of which there is no system of deduction of tax at source, he is required to make an estimate of total income which he will earn in the previous year. Such income is technically called income of the 'current year'. On such estimated income he is required to work out the tax at the rates prescribed in the Finance Act. reduce such tax by the amount of tax deducted at source, if any, and pay at least 20% of the balance tax by 15th September, 50% (after adjusting the first instalment) by 15th December and 100% (after adjusting the earlier two instalments) by 15th March of the previous year. Such payment is known as 'advance tax' for which also credit is allowed in determining the tax finally payable by or refundable to the assessee.

Self-assessment

Section 140A of the Income Tax Act requires that before an assessee submits his return to the department, he should find out the tax payable on the total income and interest payable for short payment of advance tax or for delay in submission of return. From such tax and interest he should deduct the TDS and the advance tax paid if any. If there is any amount still payable, the same should be paid and the chalan for such payment should be enclosed with the return. This is known as 'self-assessment', The self-assessment tax along with 'TDS' and 'Advance Tax' is deemed to be tax paid by the assessee towards finally determined liability and accordingly credit is allowed in determining the sum finally payable/refundable. If, therefore, the income disclosed by the assessee in the return is accepted by the Assessing Officer without making any modification therein, and if self-assessment is correctly made there should be no tax payable by or refundable to the assessee.

If he fails to make a self-assessment, the interest for short payment of advance tax at the rate of 2% per month or part thereof in respect of short payment calculated on the basis of return of income which starts running from 1st April of the assessment year continues to run up to the date of determination of tax. In addition, the assessee makes himself liable for recovery action by the department which can initiate proceedings for recovery of tax and interest due on self-assessment by any method permissible under the Act including coercive action like attachment and sale of property.

Example

During the financial year 1990-91, 'X' had following income:

1) income from salaries	Rs. 50,000 (TDS Rs. 9000)
2) share from a business	Rs. 1,00,000
3) income from interest	Rs. 10,000 (TDS 2000)

He estimated his current income at Rs. 1,20,000 and calculated advance tax as under:

Tax on 1,20,000	37,600
Add. Surcharge at the rate of 12%	4,512
	<hr/>
	42,112
Less T.D.S.	11,000
	<hr/>
	31,112

He paid 20%, i.e., 6,222 by 15th September, 1990, further 30% i.e. 9,333 by 15th December 1990 (making it 50%) and the remaining Rs. 15,557 by 15th March, 1991.

Now if the files return on 31st August showing total income at 1,60,000. He is liable to pay the following amount by way of tax and interest on self-assessment.

Tax

Tax on 1,60,000		57,600
Surcharge at the rate of 12%		6,912
		64,512
Less Paid		
TDS	11,000	
Adv. tax	<u>31,112</u>	<u>42,112</u>

Tax payable ... Rs. 22,400

Interest

Interest on 22,400 at the rate of 2% per month for 5 months (April to August)

Rs. 2,240

Amount payable on self-assessment

Rs. 24,640

Check Your Progress B

- i) What is self-assessment?
- ii) How is a self-assessment **different** from other modes of collection like advance tax or TDS?
- iii) You are going to file a return on **due date**, i.e., 30.6.1991 showing an income of Rs. 70,000 on which tax payable works out to Rs. 15,600. A sum of Rs. 12,000 has been deducted at source from salary and Rs. 1,000 from interest income. How much tax and interest is payable on self-assessment.

13.4 CONSEQUENCES OF DELAY IN FILING RETURN

If the return is not submitted by the due dates mentioned in 13.3, the following consequences follow:

- i) The Assessing Officer can, after giving an opportunity to the assessee, complete the assessment *ex parte*. *Ex parte* assessment is also known as best-judgement assessment because in such case the Assessing Officer makes an estimate of total income to the best of his judgement on the basis of whatever **information** is available with him. Although best-judgement assessment is the result of an estimate only, the courts have held that such an estimate should be reasonable and not arbitrary or capricious.
- ii) An **assessee** is liable for interest at the rate of 2% per month or part thereof from the date following the due date up to the date of actual filing of return or, if an *ex parte* assessment has been completed, up to the date of **assessment**. This interest is charged on the **amount** found payable on the determination of liability either by completion of assessment or issue of intimation and is in addition to the interest chargeable on short payment of advance tax (Refer.13.5).

Example : In the example given at the end of 13.5 if 'X' had filed the return on 15th December instead of 31st August (which was the due date) and **made self-assessment on the same day**, he would have been liable to pay the following interest.

i) Interest for short payment of advance tax (2%' per month for 9 months)	Rs. 4,032
ii) Interest for delay in filing return 2% per month on 22,400 for 4 months (September-December)	Rs. 1,792
	<u>Rs. 5,824</u>

In the same example if an *ex parte* assessment has been completed on 15th November, the interest would have been calculated for 8 months and 3 months respectively i.e., from April to November and September to November.

Please note that the charge of interest is mandatory and there is no waiver or appeal provided against it.

- iii) The assessee may even be liable for prosecution on a complaint filed by the Department in the court of competent Magistrate. On the successful completion of the prosecution proceedings, punishment may be awarded in the form of rigorous imprisonment for a term which
 - a) in a case where the tax which would have been evaded exceeds one lakh can be between six months to seven years, and
 - b) in other cases, can be between three months to three years.

In addition to rigorous imprisonment, Magistrate can also impose fine.

Prosecution cannot, however, be launched where the return, though late, was filed within the assessment year or where the tax payable after deduction of TDS and advance tax does not exceed three thousand rupees.

Check Your Progress C

You are supposed to submit your return by 31st August, 1990 but the same is delayed and actually submitted on 20th December, 1990. The pre-paid tax by way of advance tax falls short of the actual tax payable by Rs. 5,000. How much tax and interest you are required to deposit on self-assessment.

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13.5 CONSEQUENCES OF INCORRECT INFORMATION

Incorrectness in the return form can be of two types. These are discussed as follows:

- i) **Prima facie** errors : Such errors exist where information furnished by the assessee is not incorrect but in computing the total income, certain allowances, deductions or relief have been claimed which are not allowable under the provisions of Income Tax Act, or there is some arithmetical inaccuracy like totalling error etc. For instance, the assessee may without any attempt to show personal expenses as business expenses, claim such expenses in computing business income. In such cases he has not made any misrepresentation or wrong statement but has not acted in accordance with the provisions of law in computing his total income for the purpose of return. Another instance may be claim of deduction for expenses of capital nature. If the nature of such expense has been correctly stated but in computing the income such expense has been deducted, it is not misrepresentation but wrong computation of income. He may buy a car and show the payment as such but if he claims deduction for it, such incorrectness will fall in this category. These are more in the nature of 'mistake' rather than 'concealment' for which law takes a comparatively lenient view.
- ii) **Concealment**: Concealment arises where the particulars of income are concealed or inaccurate particulars of income are furnished. This type of incorrectness is more serious in nature as there is an attempt either to suppress the information which would have resulted in determination of correct income or submit such information which is not correct. For instance, the assessee may earn some commission but may not disclose it at all. Or he earns a commission of Rs. 20,000 but discloses only Rs. 10,000.

In the first case he concealed the particulars of income and in the second case he furnished inaccurate particulars of income, Other instances of the incorrectness of this type are where sales are suppressed, expenses claimed are either not incurred at all or shown at inflated figure, any income received is either not shown or suppressed or income earned by one is shown to have been earned by another with a view to get tax advantage. These are cases of 'concealment of income' and not mere computation of income in incorrect manner and, therefore, the law takes

a more serious view of such lapses. The consequences of the two types of inaccuracies are given below:

- a) If the return contains 'prima facie' errors of the nature referred above, the law authorises the Assessing Officer to correct them 'suo moto' without giving any opportunity to the assessee. Even in cases which are to be investigated, the Assessing Officer can make adjustments for such errors in the total income and work out tax payable thereon. For example if A has filed a return showing total income at Rs. 50,000 after claiming standard deduction of Rs. 15,000 out of salary income instead of Rs. 12,000 permissible under the Act, the Assessing Officer can correct this mistake on his own, compute total income at Rs. 53,000 after such 'prima facie adjustment' and issue intimation asking him to pay tax on that basis.

In order to ensure that the assessee does not make such errors deliberately to take a chance of not being detected, the law provides for charge of additional tax equal to 20% of the tax relatable to such adjustments. In the above example if tax on Rs. 53,000 is Rs. 8,810 and tax on Rs. 50,000 is Rs. 7,600 the extra tax on account of adjustment is Rs. 1,200 on which 20%, i.e., Rs. 240 will be charged from the assessee as additional tax.

- h) If the particulars of income are found to have been concealed or inaccurate particulars of income are found to have been furnished, the Assessing Officer can initiate penalty proceedings for such concealment and after giving the assessee an opportunity of being heard, impose monetary penalty of an amount ranging from 100% of the tax on concealed income to 300% of such tax. For instance, if the returned income of Rs. 50,000 is finally assessed at Rs. 1,00,000 by making addition for concealed income, the tax relatable to such additions will be Rs. 27,600 - 7,600, i.e. Rs. 20,000 and penalty imposable can be any amount between Rs. 20,000 (100% of 20,000) and Rs. 60,000 (300% of 20,000) depending upon the gravity of the action and other relevant circumstances.

In addition to the penalty that can be imposed, the assessee may be liable for prosecution in respect of the offence of wilful attempt to evade tax on a complaint filed by the Department. If the Magistrate is satisfied that he wilfully attempted to evade any tax, penalty or interest under the Income Tax Act, he may punish the assessee:

- a) with rigorous imprisonment of a term between 6 months and 7 years and with fine where the amount sought to be evaded exceeds one lakh;
- b) with rigorous imprisonment for a term between three months and 3 years with fine, in other cases.

Check Your Progress D

- i) The return filed by you shows the total income at Rs. 90,000. It is seen from the copy of the Profit and Loss account attached with the return that an amount of Rs. 10,000 spent on your medical treatment has been debited and profit has been worked out after claiming allowance of this payment. Tax on 90,000 is Rs. 23,600 and on Rs. 1,00,000 is Rs. 27,600. Can the Assessing Officer modify the income returned?
- ii) What will be the consequence of such modification made by the Assessing Officer?

13.6 PROCESSING OF RETURNS

- i) Each return form has two forms of acknowledgements attached to it. These are not mere acknowledgements but also contain the broad details of income shown in the return and other relevant information about pre-paid taxes in the form of TDS, advance tax and self-assessment tax. The person who fills in the return should also complete the entries in the acknowledgement form. When the return is submitted at the receipt counter of the income tax office, the receipt clerk signs the acknowledgement forms put the office seal thereon and hands over one copy of such form to the assessee as acknowledgement of the receipt of return containing information shown in the acknowledgement form.

- 2) These return forms are then processed in the income tax office with a view to find out whether any tax or interest is payable by or refundable to the assessee on the basis of information supplied in the return. Such processing results in one of the following situations:
 - a) The pre-paid taxes are correctly computed as a result of which there is neither any tax payable nor any refund is due to the assessee. In this situation, there is no action to be taken by the department. The assessee may keep the acknowledgement form for record and there shall be no proceedings.
 - b) The pre-paid taxes are found to be more than the tax and interest due. In this situation, a refund of an amount equal to the excess tax paid along with interest payable by the Government thereon will be made to the assessee.
 - c) The pre-paid taxes are found to be less than the amount of tax and interest found due. In this case, a letter will be issued by the Assessing Officer to the assessee intimating the amount of tax and/or interest due and asking him to pay the same within 80 days of the receipt of the letter. This letter is technically known as 'Intimation' and is considered to be a notice of demand issued by the department'. It is different from an assessment order which is passed only in selected cases after giving him an opportunity to be heard.
- 3) While working out the tax and/or interest chargeable, the Assessing Officer can make adjustments in respect of the following:
 - i) any arithmetical error in the return accounts or documents accompanying it;
 - ii) any loss carried forward, deduction, allowance or relief which on the basis of information available in such return, account or document is *prima facie* admissible but which is not claimed
 - iii) any loss carried forward, deduction, allowance or relief which has been in the return but which is *prima facie* inadmissible.

These adjustments have come to be known as 'prima facie adjustment' which can be made by the Assessing Officer 'suo moto' without giving assessee any opportunity to be heard. There is no appeal against such adjustments but if any adjustment is made not falling within any of the above three categories, the Assessing Officer can be requested to rectify the error. If the Assessing Officer refuses to rectify, you can file an appeal against such refusal. As mentioned in 13.7 there is a charge of additional tax equal to 20% of the tax attributable to such adjustments. It is, therefore, necessary that only admissible deductions, allowances and reliefs are claimed to avoid any enhancement of total income as a result of such adjustments and no chance is taken by making claims for apparently inadmissible items.

- 4) After processing the returns for the purpose of refund/intimation as mentioned above, the Assessing Officer, if he considers that the case is fit to be scrutinized for the purpose of ensuring that assessee has not understated the income or computed excessive loss or under paid tax in any manner, will serve a notice on him asking him, on a date to be specified therein, to attend his office or produce evidence to substantiate the information in the return. The Assessing Officer will after hearing the assessee, considering the evidence adduced by him and making enquiries as he may find necessary, pass an order, called 'assessment order' determining the total income and the further tax, if any, payable by him beyond the amount found payable on preliminary processing for issue of refund or intimation. A notice of demand is issued for such further amount payable within 30 days of the services of the same. The order is appealable. If the Assessing Officer comes to the conclusion that particulars of income filed were wilfully inaccurate, he may initiate penalty proceedings for concealment of income.

13.7 RE-ASSESSMENT OF INCOME

If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment either by reason of assessee's failure to file the return within the permitted time (Ref. 13.3) or for any other reason including understatement made by him in the return, he can issue a notice to the assessee asking him to furnish a return of income within the period specified in the notice and then proceed to

compute or recompute the income in the same manner as specified in 13.7 for processing of original returns. Before any such notice is issued, the Assessing Officer is bound to record reasons as to why he holds the belief about escapement of income in that case.

If the assessee's case was originally scrutinised (Refer Para 4 of 13.8), the case can be re-opened up to four years only. If four years have expired from the end of relevant assessment year, it can be re-opened only if it can be established that the escapement occurred on account of his failure to make a return or on account of his failure to disclose fully and truly all material facts necessary for the assessment of that year. Further, such assessment can be reopened after four years only if the escaped income is likely to exceed Rs. one lakh. For re-opening of assessment beyond four years, the approval of Commissioner is also necessary. No assessment can be reopened after 10 years.

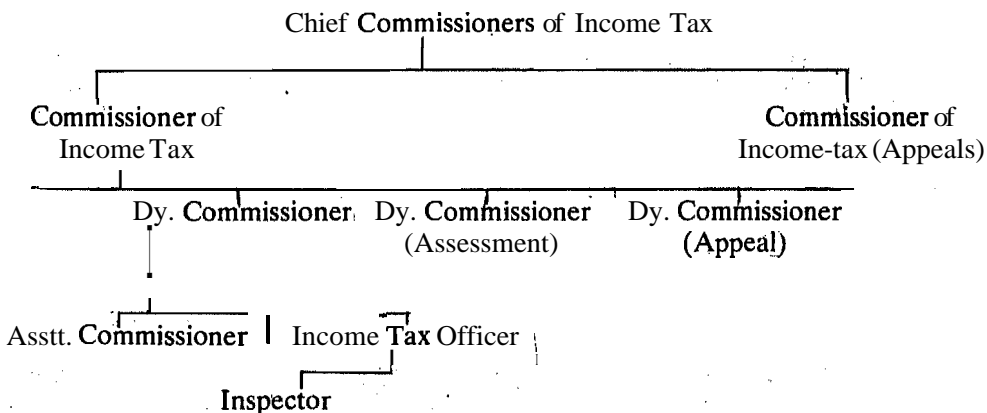
If the assessee's case was not scrutinised earlier, case can be re-opened after four and seven years only if the escaped income is likely to exceed Rs. 25,000 and Rs. 50,000 respectively. Here also no case can be reopened after 10 years.

13.8 TAX AUTHORITIES

The Central Board of Direct Taxes (CBDT) is the apex body for the administration of direct tax laws. It functions as a part of the Department of Revenue under the Ministry of Finance, Government of India. It has one Chairman and six Members. It assigns jurisdiction to Chief Commissioners of Income Tax and the Commissioners of Income Tax. The CBDT is assisted by its attached offices, viz., Directorates which function under the overall supervision of Directors-General. These Directorates are:

- i) Directorate of Income Tax
- ii) Directorate of Audit
- iii) Directorate of Research, Statistics & Public Relations
- iv) Directorate of Management Services
- v) Directorate of Systems
- vi) Directorate of Investigation
- vii) Directorate of Recovery

The CBDT is primarily a policy-making body. For actual implementation of Income Tax Act, the following chart will show the organisation set up:



Their functions in brief are as follows:

- 1) Inspectors: They are mainly responsible for outdoor duties in the matter of surveys and enquiries for assistance of the assessing officers.
- 2) Income Tax Officers: Assessing officers are responsible for the work of processing the returns, assessment, collection, recovery and other related matters within the jurisdiction assigned to them,

Deputy Commissioners: They supervise and guide the work of Assistant Commissioners/Income Tax officers.

- Dy. Commissioners (Assessment) is the Assessing Officer to whom important, cases are assigned for assessment and other related matters.
- Dy. Commissioner (Appeal) hears and decides appeal against such orders of Assistant Commissioners and income Tax Officers as the CBDT may decide.
- 4) Commissioner of Income Tax : They supervise the work of Dy. Commissioners within their charge and report to the CBDT through their Chief Commissioners. They assign jurisdiction to Dy. Commissioners within their charge. They cannot, however, interfere in the discharge of judicial functions by the Dy. Commissioners (Appeal).
 - 5) Commissioner of Income Tax (Appeals) : Appeal jurisdiction in relatively important cases from revenue angle are assigned to them. Appeal in relatively less important cases are heard and decided by the Dy. Commissioner (Appeal)
 - 6) Chief Commissioners of Income Tax : They are line between Commissioners and the CBDT and are responsible for administration and management of the offices within their zones.

13.9 LET US SUM UP

The assessee must select the proper form, must know the due dates for filing his return. The process of quantifying the tax liability starts with the filing of the tax return either voluntarily or in response to the notice issued by the Assessing Officer requiring an assessee to file the return. It is the assessee's duty to file the return voluntarily without giving the Assessing Officer an opportunity to issue a notice on him. Failure to file the return in time entails liability for payment of interest. The return should be filed with utmost care and caution as even an erroneous computation of income without any attempt to misrepresent facts may put an extra liability in the form of additional tax. If there is mis-statement of facts or suppression of fact leading to concealment of taxable income, the consequences are harsh in the form of heavy monetary penalties and/or imprisonment with fine.

The return filed may be accepted without modification or with adjustment only for very patent and obvious mistakes made. In most of the cases, the processing of returns is complete with the issue of refund or intimation. The Assessing Officer initiates the process of investigation (generally called scrutiny) by issue of notice fixing a date of hearing and asking the assessee to attend either in person or through an authorised representative to substantiate the information supplied by him. After hearing and enquiry, he determines the total income and tax payable and intimate the same by a notice of demand.

if the assessee does not file the return within the permitted time and no assessment is made *ex parte*, the Assessing Officer can still proceed to assess him but in that case he will have to record reason for his belief that income has escaped assessment. If the assessee is assessed, the Assessing Officer can re-open the completed assessment after recording similar reasons. Proceedings for such assessment or re-assessment cannot, however, be initiated if ten years have passed.

13.10 KEY WORDS

Additional Tax : This term refers to the extra charge equal to 20% of the tax attributable to enhanced income as a result of *prima facie* adjustments.

Assessment : This term refers to the determination of total income by the Assessing Officer either after hearing the tax-payer or *ex parte* in certain circumstances.

Assessment Year : This is the year following the previous year. The previous year is the financial year (1st April to 31st March) in which income is earned.

Intimation : The letter from the Assessing Officer intimating the tax and/or interest due on the basis of income returned as adjusted for patent and obvious mistakes.

Notice of Demand : A statutory notice which must be served before the demand can be enforced by coercive methods.

Prima Facie Adjustments : Adjustment to the returned income for obvious admissible or inadmissible and for correcting arithmetical inaccuracies.

Return : The prescribed form in which a tax-payer is required to submit the details of his income.

Scrutiny : The process of investigations of the return filed initiated by the Assessing Officer.

13.11 ANSWERS TO CHECK YOUR PROGRESS

- A) i) Form No. 3
Due date 30th June
- ii) Form No. 2
Due date 31st August
- iii) Form No. 2
Due date 31st October
- iv) Form No. 2
Due date ... 31st August
- v) Form No. 1
Due date 31st December
- vi) Form No. 3A
Due date 31st October
- B) i) Self-assessment means computation of liability for tax and interest by the tax-payer himself and deposit of the same before submission of return, without any demand being raised by the assessing officer.
- ii) Whereas TDS and Advance tax are collected in the previous year itself, self-assessment is made in the assessment year before the return is furnished.
- iii) Tax due 15600
Less paid by TDS 13000 ..
2600
- Interest at the rate of 2% per month for 3 months (Apr.-June) 156
2756
- C) Short Tax 5000
Interest for short payment of advance tax at the rate of 2% per month for 9 months 900
Interest for delayed return at the rate of 2% per month for 4 months 400
6300
- D) i) Assessing Officer will make 'Prima facie adjustment' of Rs. 10,000 and modify the income to Rs. 1,00,000.
- ii) An additional tax equal to 20% of Rs. 4,000 i.e., Rs. 800 will be charged.

13.12 TERMINAL QUESTIONS

Questions

- 1) What are the consequences of delay in filing return?
- 2) What steps are involved in processing a return?
- 3) What are the different tax authorities and what are their functions?

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.

SOME USEFUL BOOKS

- Bhagwati Prasad, *Law and Practice of Income Tax*, Navaman Prakashan, Aligarh (Chapters- 12, 13 & 20)
- Mahesh Chandra & S.P. Goyal, *Income Tax Law and Practice*, 1990, Himalaya Publishing House, Delhi (Chapters 13, 14 & 21)
- H.C. Mehrotra, *Income Tax Law and Accounts, 1990*, Sahitya Bhawan, Agra (Chapters 5, 12, 13 & 20)
- Vinod K. Singhanian, *Students Guide to Income Tax*, Taxman Publications Private Ltd. (Chapters 12, 14 & 26)