

# INCOME TAX - I

**COURSE CODE: B21CM07DC**

Bachelor of Commerce  
Discipline Core Course  
Self Learning Material



## **SREENARAYANAGURU OPEN UNIVERSITY**

The State University for Education, Training and Research in Blended Format, Kerala

# **SREENARAYANAGURU OPEN UNIVERSITY**

## **Vision**

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## **Mission**

To be benchmarked as a model for conservation and dissemination of knowledge and skill on blended and virtual mode in education, training and research for normal, continuing, and adult learners.

## **Pathway**

Access and Quality define Equity.

**Income Tax - I**  
Course Code: B21CM07DC  
Semester - IV

**Discipline Core Course**  
**Bachelor of Commerce**  
**Self Learning Material**  
**(With Model Question Paper Sets)**



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# INCOME TAX - I

Course Code: B21CM07DC

Semester- IV

Discipline Core Course

Bachelor of Commerce

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# MESSAGE FROM VICE CHANCELLOR

Dear learner,

I extend my heartfelt greetings and profound enthusiasm as I warmly welcome you to Sreenarayanaguru Open University. Established in September 2020 as a state-led endeavour to promote higher education through open and distance learning modes, our institution was shaped by the guiding principle that access and quality are the cornerstones of equity. We have firmly resolved to uphold the highest standards of education, setting the benchmark and charting the course.

The courses offered by the Sreenarayanaguru Open University aim to strike a quality balance, ensuring students are equipped for both personal growth and professional excellence. The University embraces the widely acclaimed “blended format,” a practical framework that harmoniously integrates Self-Learning Materials, Classroom Counseling, and Virtual modes, fostering a dynamic and enriching experience for both learners and instructors.

The University aims to offer you an engaging and thought-provoking educational journey. The Bachelor of Commerce is one of the highly popular programmes due to the current need for skilled professionals in the field. This demand guided our approach as we developed the programme's curriculum. The programme offers a comprehensive grasp of theoretical concepts alongside clear explanations of practical applications. We are careful to maintain a balance in the management components to preserve the integrity of the discipline. The Self Learning Material has been thoughtfully crafted to include illustrative examples. The Self-Learning Material has been meticulously crafted, incorporating relevant examples to facilitate better comprehension.

Rest assured, the university's student support services will be at your disposal throughout your academic journey, readily available to address any concerns or grievances you may encounter. We encourage you to reach out to us freely regarding any matter about your academic programme. It is our sincere wish that you achieve the utmost success.



Warm regards.  
Dr. Jagathy Raj V. P.

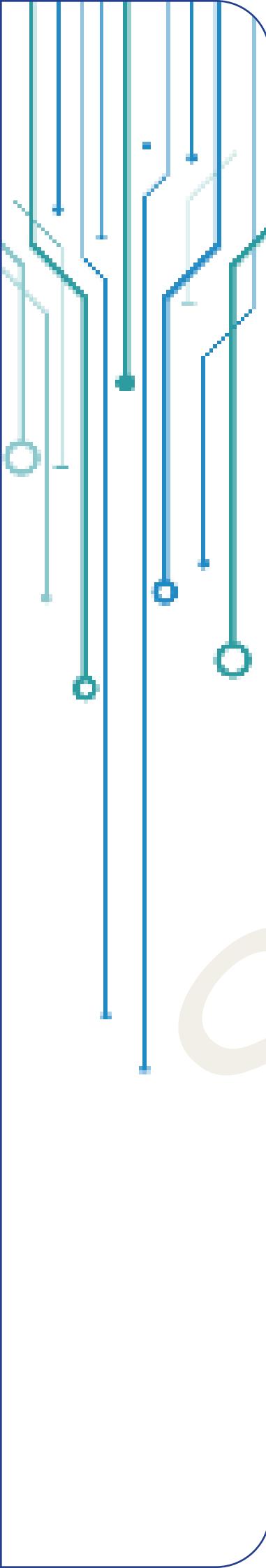
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1  
BLOCK

Basic concepts of  
income tax



# Unit 1

## Introduction

### Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ develop an understanding of the concept of tax and its evolution
- ◊ comprehend the classification of tax regime
- ◊ equip the learner with the merits and demerits of tax structure

### Prerequisites

The tax was first introduced in India in 1860 by Sir James Wilson to address the financial losses incurred by the Government due to the Military Mutiny of 1857. Subsequently, numerous amendments were implemented periodically.

The power to impose taxes is conferred by the Constitution of India, which distributes the authority to levy different taxes between the Union Government and the State Governments. Article 265 of the Constitution imposes a significant limitation on this power, asserting that "No tax shall be levied or collected except by the authority of law". Consequently, every tax imposed or collected must be supported by a corresponding law enacted by either Parliament or the State Legislature. Tax evasion remains a significant issue in India, ultimately precipitating numerous adverse consequences for the nation.

### Keywords

Tax, Direct Tax, Indirect Tax, Finance Act,CBDT

## Discussion

### 1.1.1 Brief History of Income Tax in India

This tax was first introduced in India in 1860 by Sir James Wilson to address the financial losses incurred by the Government due to the Military Mutiny of 1857. Subsequently, numerous amendments were implemented periodically. Finally, in 1886, a distinct Income Tax Act was enacted. This Act remained in effect until 1917, with periodic changes made. In 1918, a new Income Tax Act was enacted, subsequently replaced by another Act in 1922. This Act was effective until the Assessment Year 1961-62, with multiple amendments.

The Income Tax Act of 1922 had become exceedingly complex due to numerous amendments. The Government of India consequently referred the matter to the Law Commission in 1956 to simplify tax regulations and prevent evasion. In September 1958, the Law Commission submitted its report; however, concurrently, the Government of India had established the Direct Taxes Administration Enquiry Committee to propose strategies for reducing assessment inconveniences and preventing tax evasion. The Committee presented its report in 1959. The Income Tax Act of 1961 was enacted following consultations with the Ministry of Law.

The Income Tax Act of 1961 came into effect on April 1, 1962. It encompassed the entirety of India. Since 1962, numerous significant amendments to the Income Tax Act have been enacted annually through the Union Budget, which includes the Finance Bill. Upon approval by both Houses of Parliament and receiving the President of India's assent, it is enacted as the Finance Act. Additionally, modifications have been instituted through various Amendment Acts, including The Taxation Laws Amendment Act of 1984; The Direct Taxes Amendment Act of 1987; The Direct Taxes Law (Amendment) Acts of 1988 and 1989; The Direct Taxes Law (Second Amendment) Act of 1989; The Taxation Laws (Amendment) Act of 1991; The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act of 2020; and finally, The Taxation Laws (Amendment) Act of 2021. The Income Tax Act of 1961, effective from April 1, 1962, has undergone significant amendments and revisions. Consequently, it has become exceedingly complex for both the governing authorities and the taxpayers.

### 1.1.2 Central Board of Direct Tax(CBDT)

The Central Board of Direct Taxes (CBDT) is an official organization operating under the Department of Revenue in the Ministry of Finance, Government of India. It manages the administration of direct taxes such as income tax and corporate tax via the Income Tax Department. Established in 1964 under the Central Board of Revenue Act, 1963, the CBDT plays a crucial role in tax governance. The equivalent organization for indirect taxes is the Central Board of Indirect Taxes and Customs (CBIC).



### 1.1.3 Components of Income Tax Law

#### ◊ The Income Tax Act, 1961

It is an act to levy, administer, collect, and recover income tax in India. The act is effective from 1 April 1962. It consists of 298 sections and 14 schedules. The act helps determine a taxpayer's taxable income, tax liability, appeals, penalties, and prosecution. The government has been making amendments to the act from time to time.

#### ◊ Income Tax Rules, 1962

Income tax rules act as a supplement to the Income Tax Act, 1961. Income tax rules are effective from 1 April 1962. The Central Board of Direct Taxes (CBDT) has the power to amend the income tax rules.

#### ◊ Annual Finance Act

Amendments in the Income Tax Act 1961 are effected every year through the annual Finance Act. Every year, a budget is presented before the parliament by the finance minister. One of the important components of the budget is the finance bill. This bill contains various amendments in the income tax and other law to prescribe the additions and deletions therein.

#### ◊ Circulars

Circulars and clarifications are issued by CBDT to clarify the doubts regarding the scope and meaning of certain provisions of the law, and primarily to provide guidance to the income tax officers. These circulars are binding on the income tax authorities but not on the assessee; however, an assessee can take the benefits of these circulars.

### 1.1.4 The Finance Act

The Finance Act is the fiscal legislation passed by the Indian Parliament to implement the financial proposals of the Central Government. It is enacted annually and encompasses provisions pertaining to income taxes, customs duties, excise taxes, Central and Integrated GST, as well as various cesses, exemptions, and reliefs. It may also include provisions to amend other statutes as the Government implements its fiscal policy. The bill, commonly referred to as the budget, is presented in Parliament by the Finance Minister. The essential element is the regulations established in the Act concerning Income Tax Rates. Annually, the Act outlines all pertinent provisions concerning Income Tax within the nation. The Finance Act establishes the tax rates applicable to taxpayers. The Act encompasses numerous particulars pertaining to:

- ◊ Salary Income
- ◊ Agricultural Income
- ◊ Income tax rates for Senior Citizens
- ◊ Tax rates for particularly Senior Citizens
- ◊ Income Tax Surcharges
- ◊ Taxes chargeable to companies
- ◊ Advance tax

## 1.1.5 Tax

A tax is defined as a financial obligation imposed on individuals or property owners to finance the Government a payment mandated by legislative authority. A tax is an obligatory contribution, mandated by legislative authority, rather than a voluntary payment or donation. Tax is a financial obligation imposed on individuals by the Government, utilised for the provision of public services.

## 1.1.6 Classification of Tax

Taxes are typically categorised into 'Direct Taxes' and 'Indirect Taxes'.

### 1.1.6.1 Direct Taxes

Direct taxes encompass those imposed on property, individuals, businesses, and income, whereas indirect taxes are applied to goods prior to their consumption by end-users. Dalton defines a direct tax as one that is paid by the individual upon whom it is legally levied, and the burden of which cannot be transferred to another individual. The individual from whom it is collected cannot transfer its obligation to another party. Consequently, the impact, or initial burden, and the incidence, or ultimate burden, of a direct tax are borne by the same individual. The taxpayer is the individual responsible for bearing the tax burden. Consequently, the category of direct taxes encompasses income tax, corporate tax, capital gains tax, and capital levy.

#### 1.1.6.1.1 Advantages of Direct Taxes

1. Direct taxes are determined by taxable capacity, and their burden is equitably allocated.
2. Direct taxes are progressive, imposing elevated rates on higher income brackets and reduced rates on lower income brackets. Individuals with low income are exempt from direct taxation.
3. The government can project tax revenues and reconcile its income and expenditures. The assessee is also certain regarding the tax amount.
4. Direct taxes exhibit elasticity, whereby elevated government revenues can be achieved through the augmentation of tax rates.
5. Direct taxes are efficient since they do not influence productive capacity in the short term. Indirect taxes exert a greater influence on productivity capacity.
6. Direct taxes are founded on the principle of Distributive Justice, as they contribute to mitigating pronounced disparities in income and wealth.

#### 1.1.6.1.2 Disadvantages of Direct Taxes

1. The tax rates are determined arbitrarily by the governments. The rates of income tax are contingent upon political will rather than justification.
2. Direct taxes incentivise taxpayers to conceal their income, resulting in the proliferation of black money. Taxpayers maintain fraudulent accounts and evade tax payments.

3. The elevated rate of direct taxes diminishes the savings capacity of individuals, as a substantial portion of income is appropriated in the form of taxes, adversely impacting the rate of capital formation.
4. Direct taxes do not encompass everyone. These encompass only a segment of the salaried class within society. Business class avoid direct taxation through the manipulation of financial accounts.

### 1.1.6.2 Indirect Taxes

Indirect taxes are taxes that primarily impose their burden or impact on an individual. However, that individual manages to transfer his responsibilities to others. An indirect tax is levied on one individual but is partially or entirely borne by another. Indirect taxes are transferred, resulting in the burden of these taxes being borne by individuals other than the initial payers. The indirect taxes of the Union Government include:

- i. Customs Duty
- ii. Excise Duty
- iii. Central Sales Tax (CST)
- iv. Service Tax.

Indirect taxes are advantageous for both the taxpayer and the government. Taxes are incurred solely upon the purchase of goods; thus, the taxpayer does not perceive the burden of taxation. This tax is advantageous for the government as it directly collects funds from producers or importers.

Table 1.1.1 Difference between direct tax and indirect tax

DIRECT TAX	INDIRECT TAX
The individual remitting the tax to the Government directly endures the burden of the tax.	The taxpayer remits the tax to the Government, subsequently recovering it from the final consumer. Consequently, the burden of the tax is transferred to another individual.
Elevated tax rates for individuals with greater financial capacity.	All consumers uniformly share the burden.
Tax burden incurred by the individual	Tax burden transferred to another individual

#### 1.1.6.2.1 Characteristics of Indirect Taxes

1. The manufacturer pays central excise duty, which is subsequently incorporated into the commodity's cost.
2. Indirect taxation refers to commodity taxation, as the central excise duty is imposed on commodities produced anywhere in India.
3. In the case of direct taxes, the taxpayer's capacity is assessed directly, whereas for indirect taxes, the taxpayer's capacity is assessed indirectly.

4. The taxpayer does not experience an immediate burden when remitting indirect taxes.
5. Indirect taxes are simpler to collect, and a higher revenue generation is guaranteed due to comparatively lower tax evasion in the organised sector.
6. The taxation levied on goods directly influences their prices.

#### **1.1.6.2.2 Merits of Indirect Taxes**

1. Indirect taxes are more convenient to remit. These taxes, typically levied on commodities, are incorporated into prices.
2. Indirect taxes do not elicit resentment, as they generate less irritation among the public due to their indirect nature.
3. Indirect taxes are challenging to evade since they are typically incorporated into prices.
4. Indirect taxation, typically comprising commodity taxes, possesses a wider scope. The low-income segments of society, which are exempt from direct taxation, can readily be ensnared by such taxes.
5. Indirect taxes possess significant social value. They can enhance social cohesion, morale, and public health by deterring the consumption of detrimental substances such as intoxicants and tobacco.
6. Indirect taxes serve as an efficient mechanism for extracting consumer surplus and reallocating the community's savings potential to the government.
7. Indirect taxes can indeed function as a complement to direct taxes.
8. Indirect taxes on luxuries and semi-luxuries exhibit a progressive effect, as they are imposed on the consumption expenditures of affluent individuals.

#### **1.1.6.2.3 Demerits of Indirect Taxes**

1. Indirect taxes are unjust and inequitable due to their regressive nature because they are assessed at a proportional rate on commonly consumed commodities.
2. Indirect taxes fail to adhere to the principles of economy and productivity. The multi-stage nature of these taxes typically results in a high cost of collection relative to the revenue generated.
3. Excessive reliance on indirect taxes results in inflationary effects. In India, excessive indirect taxation on mass consumption commodities is a significant factor contributing to the inflationary price spiral.
4. Indirect taxes impede savings as individuals are compelled to expend more due to increased commodity prices.
5. Indirect taxes are unnoticeable and collected via intermediaries such as traders, thus failing to foster civic responsibility.

## Recap

- ◊ Tax is a financial obligation imposed on individuals or property owners.
- ◊ Tax is an obligatory contribution rather than a voluntary payment or donation.
- ◊ Direct taxes encompass those imposed on property, individuals, businesses, and income.
- ◊ Indirect taxes are applied to goods prior to their consumption by end-users.

## Objective Questions

1. Who introduced the first income tax in India and in what year?
2. Who approves the Finance Act?
3. Who levies taxes in India?
4. Income tax is a direct tax. why is it called that?
5. Point out anyone category of Direct Tax?
6. State any categories of Indirect Tax?
7. Expand CBDT
8. The type of tax which burden can not be transferred to another individual?

## Answers

1. Sir James Wilson in 1860.
2. Indian Parliament
3. Central Government
4. Remits payment directly.
5. Income Tax.
6. Customs Duty, Excise Duty
7. Central Board of Direct tax
8. Direct tax

## Assignments

1. Evaluate the significance of the tax framework established by the Government for individuals.
2. Evaluate the impact of direct and indirect taxes on taxpayers.
3. Point out the differences between direct taxes and indirect taxes.
4. Describe the evolution of income tax in India.
5. Provide a concise overview of the Finance Act.
6. What are the fundamental differences between direct tax and indirect tax?
7. How can direct taxes impact the saving capacity of individuals?
8. What are the key advantages of indirect taxes for the government?
9. How does the taxpayer's perception of the tax burden differ between indirect taxes and direct taxes?
10. What factors might cause a taxpayer not to recognise the indirect tax burden?

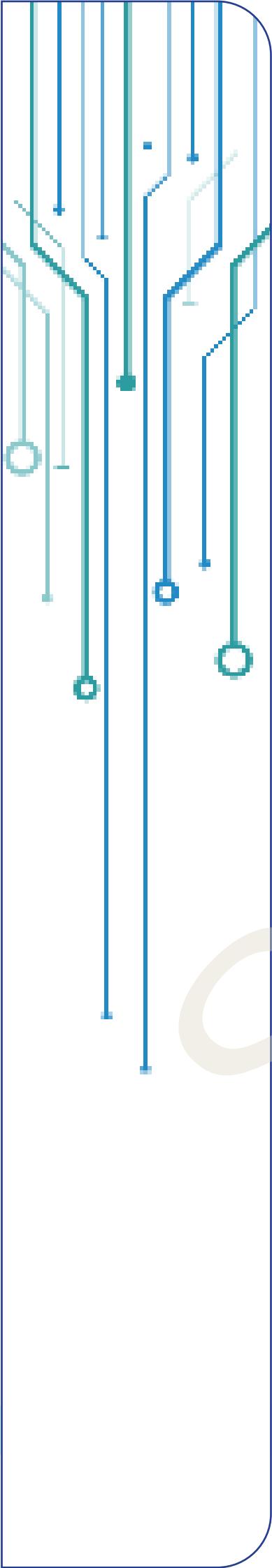
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## Suggested Reading

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# Unit

## Basic Concepts

### Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ develop an understanding of the concept of income and total income
- ◊ comprehend the difference between Gross Total Income and Total Income
- ◊ equip the learner with the concept of Accelerated Assessment
- ◊ gain knowledge about the concept of rebate of income tax

### Prerequisites

An income tax assessee is an individual who remits tax or any monetary amount pursuant to the stipulations of the Income Tax Act, 1961. Moreover, Section 2(7) of the act depict an income tax assessee as any individual obligated to remit taxes on any earned income or realised loss within a single assessment year. The year in which income is generated is referred to as the previous year, while the subsequent year in which that income is subject to taxation is termed the assessment year. The previous year refers to the financial year directly preceding the assessment year and the assessment year follows immediately after the Financial Year.

### Keywords

Income, Total Income, Person, Assessee, Assessment Year, Previous Year, Accelerated Assessment

## Discussion

### 1.2.1 Definition

Sections 2 and 3 of the Income Tax Act 1961 provide definitions for significant terms utilised within the Act, including the following:

### 1.2.2 Income [Sec. 2(24)]

This term is significant as income tax is levied on an individual's earnings. The subject matter pertains to the Income Tax Act. This term is not defined in the Income Tax Act, other than specifying what constitutes income.

Under this section, income includes:

- i. profits and gains;
- ii. Dividend;
- iii. Voluntary contributions received (a) by a trust established wholly or partially for charitable or religious purposes, (b) by an institution established wholly or partially for such purposes, (c) by a scientific research association as referenced in section 10(21), (d) by a games or sports association or institution as referenced in section 10(23), (e) by a charitable fund or institution, or by a trust or institution dedicated entirely to public religious and charitable purposes, or any university or educational institution, or any hospital or other institution as referenced in section 10(23C) (iiiad), (iiiae), (iv), (v), (vi), and (via), or (f) by an electoral trust;
- iv. The value of any perquisite or profit in lieu of salary is taxable under the category 'Income from Salary.'
- v. Any specific allowance or benefit, apart from the perquisites mentioned in clause (iv), explicitly provided to the assessee to cover expenses that are wholly, necessarily, and exclusively incurred in the execution of his duties;
- vi. Any allowance provided to the assessee to cover personal expenses at their duty location or to offset the heightened cost of living, such as City Compensatory Allowance;
- vii. The value of any advantage or perquisite (regardless of its convertibility into currency) acquired by any representative assessee or beneficiary, or any sum disbursed by the representative assessee for the beneficiary's benefit (which the beneficiary would typically be obligated to pay);
- viii. The value of any advantage or benefit acquired from a company by a director, an individual with significant interest in the company, or a relative of either the director or such individual;
- ix. Any amount disbursed by any such company concerning any obligation that, in the absence of such payment, would have been owed by the director or other individual specified in (viii) above;

- x. Any amount subject to income tax under the category 'Profits and Gains of Business or Profession' as per section 28(ii), as compensation or under section 28(iii) as income of a trade or professional association derived from specific services for its members, or under section 41 as profits liable to taxation;
- xi. Any interest, salary, bonus, commission, or remuneration received by a partner from the firm under section 40(b) as per section 28(v);
- xii. Any profits derived from the sale of a license issued under the Imports (Control) Order, 1955 [section 28(iiia)];
- xiii. Cash assistance obtained or entitled to be obtained by any individual for exports under any scheme of the Government of India [section 28(iiib)];
- xiv. Any customs duty or excise refunded or refundable to any individual in relation to exports [section 28(iiic)];
- xv. The worth of any advantage or benefit derived from business or professional practice [section 28(iv)];
- xvi. Any capital gains subject to taxation under section 45;
- xvii. The profits and gains of any insurance business carried out by a mutual insurance company or a cooperative society, calculated in accordance with section 44;
- xviii. Any earnings from lotteries, crossword puzzles, races, including equestrian events, card games, and any other games of chance or from gambling or betting of any kind;
  - 1. "Lottery" encompasses winnings from prizes conferred to individuals through a draw of lots, chance, or any other method.
  - 2. "Card game and other games of any kind" encompasses any game show, an entertainment program on television or electronic platforms, wherein individuals compete for prizes or engage in similar activities.
- xix. Any amount received by the assessee from employees as contributions to a provident fund, superannuation fund, any fund established under the Employees' State Insurance Act, or any other fund designated for the welfare of such employees;
- xx. Any amount received under a Keyman Insurance Policy, including bonuses associated with such a policy.
  - 1. In clause (viii), 'a person who has substantial interest in the company' refers to an individual who is the beneficial owner of shares representing at least 20% of the voting power.
  - 2. Clause (xx) defines Keyman Insurance Policy as a life insurance policy acquired by an individual on the life of another individual who is or was (i) an employee of the former, or (ii) associated in any capacity with the business.

The valuation of the Keyman Insurance Policy is determined as follows:

1. On receipt of the sum by the organisation that has acquired the policy, it is subject to assessment under the category 'Profits and Gains of Business or Profession'.

2. On receipt of the amount by the employee, it is deemed assessable as profits in lieu of salary.
3. When an individual receives an amount and there is no employer-employee relationship (such as with a Chairman or Director of a company), it is classified as 'Income from Other Sources.'

xxi. Any amount mentioned in section 28(va), specifically, any amount, whether received or to be received in cash or in kind, under an agreement for:

- a. Not carrying out any activity in relation to any business; or
- b. Refraining from disclosing any proprietary knowledge, patents, copyrights, trademarks, licenses, franchises, or any other business or commercial rights of a comparable nature, as well as information or techniques that could facilitate the production or processing of goods or the provision of services.

xxii. Any consideration received for the issuance of shares that exceeds the fair market value of the shares.

xxiii. The profits and earnings derived from any banking operations, including the provision of credit facilities, conducted by a co-operative society with its members.

xxiv. Any monetary sum received as an advance during negotiations for the transfer of a capital asset, which subsequently fails, shall be forfeited.

xxv. Any cash or in-kind receipt from the Central Government, a State Government, or any authority, body, or agency will be classified as income for the assessee.

Subsidy, grant, cash incentive, duty drawback, waiver, concession, or reimbursement. Nevertheless, if a subsidy, grant, or reimbursement is considered in calculating the actual cost of the asset, it will not be classified as income. The subsidy or grant from the Central Government intended for the corpus of a trust or institution established by either the Central or State Government shall not be classified as income. Subsidies for LPG and other welfare benefits received by an individual personally, rather than in relation to their business or profession, shall be excluded from income.

xxvi. Any monetary amount or property value acquired without adequate consideration by any individual from any individual or individuals on or after April 1, 2017.

xxvii. Compensation or any other payment owed or received by an individual in relation to the cessation of employment or alteration of the associated terms and conditions.

xxviii. The fair market value of inventory on the date it is converted into, or regarded as, a capital asset.

xxix. Any sum referred to in section 56(2)(xii).

xxx. Any sum referred to in section 56(2)(xiii).

### 1.2.3 Concept Of Income

The above definition of income is not definitive. It encompasses additional receipts that are typically classified as income. Income refers to monetary earnings obtained from specific sources with a degree of consistency or anticipated consistency. The specific

sources of income are: Salary Income, Income from Property, Business or Professional Profits and Gains, Capital Gains, and Income from Other Sources. If the income is not obtained from any of the above sources, it is not subject to taxation under the Indian Income Tax Act. For instance, if an individual discovers a purse containing ₹ 1,000 on the street, it cannot be classified as income since it is not derived from a specific source.

Additionally, there are several other significant regulations pertaining to income, outlined as follows:

1. A definitive source of income is necessary. The presence of an income source is crucial for categorising a receipt as taxable income.
2. All income, regardless of its legality, is subject to taxation under the Income Tax Act, unless otherwise exempted as non-taxable income. The Income Tax Act does not differentiate between lawful and unlawful income. Nonetheless, any expenses incurred to generate illegal income may only be deducted from that income.
3. It is not essential for the income to be received consistently and periodically, such as weekly, monthly, or quarterly. A lump sum received may constitute income, contingent upon various factors and considerations.
4. Revenue should be generated externally. In an institution, if the income derived from member subscriptions surpasses the expenditure on those members, the surplus cannot be classified as taxable income. This is because the subscriptions originate from the members themselves, and the surplus reflects the difference between income and expenditure incurred for their own benefit; thus, it is not considered external income and will not be deemed taxable income. Likewise, surplus revenue generated by a club from amenities offered to members as part of membership benefits is not considered taxable income.
5. It is not necessary for the income to be received in monetary form. In-kind or service receipts with a monetary equivalent may also constitute income.
6. If an assessee has generated income but has not yet received it, it will be regarded as the assessee's income, as they are entitled to receive it.
7. The reimbursement of actual travel expenses to an employee does not constitute income.
8. When a legal obligation establishes a charge on an individual's income, that charge will be deducted from their income to the corresponding extent.
9. Receipt on Account of Dharmada, Gaushala, etc., is not income.
10. Pin Funds received by a wife for personal expenditures and minor savings accrued by a woman from money provided by her husband for household expenses do not constitute her income.
11. Any contention concerning the title of income shall not delay or impede the assessment of that income. The recipient of such income will be subject to taxation.
12. Diversion of income refers to the allocation of income to another individual due to a legal obligation. If the income is transferred to another party after receipt,

it constitutes the application of income. Likewise, if income is voluntarily allocated to another individual, it constitutes an application of income. If income is diverted before it reaches the assessee due to an obligation, it constitutes a diversion of income and is not taxable. However, if the income must be utilised to fulfill an obligation after it has reached the assessee, it is merely an application of income, and tax liability cannot be evaded.

13. Any additional funds received by an assessee due to currency devaluation constitute taxable income.
14. Income may be positive or negative. Negative income signifies a loss; therefore, losses are encompassed within the definition of 'Income'.

#### **1.2.4 Gross Total Income [Sec. 80b(5)]**

It refers to the aggregate income calculated in accordance with the stipulations of the Income Tax Act, prior to any deductions under sections 80C to 80U. The gross total income is calculated as follows:

Initially, the assessable income for each category is calculated. When determining the final amount of assessable income for each category, losses from certain sources are offset against incomes from other sources within the same category. Subsequently, unabsorbed losses are offset against incomes from other categories, wherever legally permissible. Subsequently, carried forward losses, unabsorbed depreciation, and similar items are offset in accordance with the stipulations of the Income Tax Act. The total amount of assessable income for each category is subsequently combined. The resulting sum is referred to as 'Gross Total Income'.

#### **1.2.5 Total Income [Sec. 2(45)]**

Total income refers to the aggregate income specified in section 5, calculated according to the provisions of the Income Tax Act. According to section 5, various sources of income of an assessee are aggregated into their total income based on their residency status. The calculation of these incomes is conducted in accordance with the stipulations of various sections of the Act under the categories of Salaries, Income from House Property, Profits and Gains of Business or Profession, Capital Gains, and Income from Other Sources. Total income refers to the amount remaining after applying deductions specified in sections 80C to 80U from the gross total income.

#### **1.2.6 Difference Between Gross Total Income and Total Income**

Table 1.2.1 Difference Between Gross Total Income and Total Income

<b>Gross Total Income</b>	<b>Total Income</b>
The aggregate of various heads of income is called Gross Total Income.	After deductions under sections 80C to 80U, the balance is called Total Income.

Gross Total Income is not rounded off.	Total Income is approximated to the nearest multiple of ten rupees.
Tax is not imposed on Gross Total Income.	Tax is imposed on the Total Income at the prescribed rates.
Gross Total Income cannot be less than Total Income.	Total Income can be equal to or less than GTI.
Agricultural income is not included in GTI.	If agricultural income surpasses ₹5,000, it is incorporated into the Total Income of an individual or Hindu Undivided Family (HUF) to ascertain the tax liability of the assessee.

### 1.2.7 Casual Income

- i. Any receipt that is casual and non-recurring constitutes casual income. Casual income refers to income received accidentally and without any contractual obligation. It is in the nature of an unexpected windfall. Income from lotteries, crossword puzzles, card games, and all forms of gambling or betting is classified as casual income. Earnings from regular betting activities are classified as non-recurring receipts and are subject to assessment as casual income. Casual income excludes:
  - a. Capital gains, subject to the provisions of section 45; or
  - b. Income generated from business operations or the practice of a profession or vocation; or
  - c. Receipts, by way of addition to the remuneration of an employee, such as a bonus, gratuity, perquisites, etc.
- ii. Voluntary payments received in the course of an occupation are not classified as casual income; for instance, tips routinely given to taxi drivers employed by taxi owners constitute income derived from the exercise of an occupation. Likewise, tips given to hotel wait staff are subject to taxation. A receipt may be subject to taxation as income derived from the lawful practice of a profession, even if the sum is received as a gift from third parties to whom legal services were not provided and who had no obligation to make any payment. If an architect submits a plan in a construction competition, the prize awarded constitutes professional income.
- iii. A gift from a relative is not considered income. Birthday and wedding gifts serve as the most straightforward examples. A gift from a relative does not constitute income solely due to its annual recurrence. A recurring allowance provided annually as a voluntary gift from a parent to a child, a husband to a wife, or one relative to another constitutes a new gift with each payment and does not qualify as income.
- iv. Payment from a husband to his wife pursuant to a separation agreement as a maintenance allowance is neither incidental income nor a personal gift. Therefore, it is subject to taxation.



- v. A prize awarded for coin or stamp collection may constitute a supplementary income. This income arises from a hobby.

### **1.2.8 Other Provisions Relating to Casual Income**

- i. Expenses are not deductible: Expenses incurred to obtain casual income are not deductible from any income. For instance, an individual who purchases lottery tickets cannot deduct the cost of these tickets from any income. Likewise, if postal fees have been incurred for dispatching crossword puzzles, such expenses are not deductible from any income.
- ii. Set-off of losses not permitted: In the event of a casual loss rather than casual income, such a loss cannot be offset against any income. For instance, if an individual wins in a card game on the first day and subsequently incurs a loss the following day, he cannot offset the loss against any income.
- iii. Tax deduction at source:
  - a. If the horse race winnings exceed ₹10,000, tax will be withheld at the stipulated rate.
  - b. Winnings from any lottery, crossword puzzle, card game, or similar game exceeding ₹10,000 will incur tax deduction at source at the specified rate.
- iv. Rate of tax: On winnings from lotteries, crossword puzzles, races, gambling, betting, etc., tax is chargeable @ 30%.

### **1.2.9 Maximum Marginal Rate [Sec. 2(290)]**

It refers to the income tax rate (including any applicable surcharge) pertinent to the highest income bracket for individuals, Associations of Persons, or Bodies of Individuals as delineated in the Finance Act of the respective year.

### **1.2.10 Assessment Year [Sec. 2(9)]**

Assessment year means the period of 12 months commencing on the first day of April every year and ending on 31st March of the next year. An assessee is obligated to remit tax on the income earned in the preceding year during the subsequent financial year (assessment year). For example, during the Assessment Year 2025-26, tax shall be paid for the Previous Year 2024-25.

### **1.2.11 Previous Year (Sec. 3)**

1. Previous year means the financial year immediately preceding the assessment year. Financial Year begins on 1st April and ends on 31st March.
2. For a newly established business, profession, or any new source of income during the financial year, the previous year commences from the date of establishment of the new entity and concludes at the end of that financial year. In this instance, the preceding year may consist of fewer than 12 months.

The year in which income is generated is referred to as the previous year, while the subsequent year in which this income is subject to taxation is termed the assessment year. Income tax is levied on the total income of the preceding year at the rates established by the applicable Finance Act for the assessment year.

3. No assessee is obligated to close their accounts exclusively on March 31st. An assessee may choose to close their accounts on a date other than 31st March for personal, religious, or other reasons. He must also reconcile his accounts by 31st March to facilitate the submission of his income tax return. A financial year encompasses both the preceding year and the assessment year. The previous year refers to the income generated during the financial year, while the assessment year pertains to the income accrued in the preceding financial year.

### **1.2.12 Exceptions to the General Rule/Accelerated Assessment (Cases Where Income of A Previous Year is Assessed in the Previous Year Itself)**

Income tax is levied on the earnings of the preceding year during the assessment year. Nonetheless, there are specific exceptions to this principle. The assessee is subject to taxation in the same year in which the income is earned in the following circumstances:

- i. Income of non-residents derived from shipping operations (Section 172)

A non-resident engaged in shipping business without a representative in India will have any income from transporting passengers, livestock, mail, or goods shipped from an Indian port taxed in the year it is earned. 7.5% of the sum disbursed or due for such transportation shall be considered as income. Indeed, the vessel will be prohibited from departing the port until the tax on the income has been settled or alternative tax payment arrangements have been established.

- ii. Income of persons leaving India (Sec. 174)

If the Assessing Officer determines that an individual may depart from India during the current assessment year or shortly thereafter, and that the individual has no intention of returning, the total income of that individual from the end of the previous year for the assessment year until the anticipated date of departure shall be subject to taxation in the same assessment year.

- iii. Revenue generated by an Association of Persons, a Body of Individuals, or an Artificial Juridical Person established for a specific event or objective (Sec. 174A)

If the Assessing Officer determines that any Association of Persons (A.O.P.), Body of Individuals (B.O.I.), or Artificial Juridical Person has been created for a specific event or purpose and is likely to be dissolved within the assessment year of its formation or immediately thereafter, the total income of such entity from the end of the previous year for that assessment year until the date of its dissolution shall be subject to taxation in that assessment year.

iv. Transfer of property to avoid tax (Sec. 175)

If the Assessing Officer believes that an assessee may transfer property to evade taxation, the total income of that individual from the end of the previous year for the assessment year until the commencement of proceedings under section 175 shall be subject to taxation in the same assessment year.

v. On discontinuance of a business or profession (Sec. 176)

Upon the end of a business or profession, the income generated from the conclusion of the preceding year to the date of discontinuance may, at the discretion of the Assessing Officer, be subject to taxation in the same assessment year.

### **1.2.13 Difference Between the Previous Year and the Assessment Year**

Table 1.2.2 Difference Between the Previous Year and the Assessment Year

<b>The Previous Year</b>	<b>The Assessment Year</b>
Section 3 of the Income Tax Act pertains to the Previous Year.	Section 2(9) pertains to the Assessment Year.
Previous Year refers to the financial year directly preceding the assessment year.	Assessment Year means the period of twelve months commencing on the first day of April every year and ending on 31st March of the next year.
The Previous Year may be less than 12 months in case of a newly set-up business or profession.	The Assessment Year will consistently cover a duration of 12 months.
The year during which income is generated is referred to as the Previous Year.	The next year in which the previous year's income becomes taxable is known as the Assessment Year.

### **1.2.14 Person [SEC. 2(31)]**

'Person' includes the following:

(i) an individual, (ii) a Hindu Undivided Family, (iii) a corporation, (iv) a partnership (including Limited Liability Partnership), (v) an Association of Persons or a Body of Individuals, whether incorporated or not, (vi) a local authority, and (vii) every Artificial Juridical Person not encompassed by any of the aforementioned sub-clauses. An individual refers to a natural person or human being, encompassing male, female, minor, or mentally incapacitated individuals. A Hindu Undivided Family refers to a Hindu family comprising all individuals lineally descended from a common ancestor, including their spouses and unmarried daughters. A company is an artificial entity established by law, characterised by perpetual succession, a common seal, and shares that confer limited liability.

As per section 2(17) of the Income Tax Act, a company means:

- i. Any Indian company, or
- ii. Any corporate incorporated under the law of a foreign country, or
- iii. Any institution, association, or entity, regardless of incorporation status and whether Indian or foreign, that is designated as a company by a general or special order of the Central Board of Direct Taxes.

A firm refers to a partnership firm, including a Limited Liability Partnership, as defined by the Partnership Act. An Association of Persons refers to two or more individuals uniting for a shared objective aimed at generating income. The A.O.P. may comprise two or more individuals or entities, such as an individual and a corporation, or multiple corporations. The body of Individuals refers to a collection of individuals who unite by coincidence, such as through birth or testamentary provisions. The Supreme Court has determined that when a business is continued by a widow on her own behalf and on behalf of her minor children after an individual's death, the profits are subject to assessment as a Body of Individuals (BOI). A local authority encompasses a municipality, Municipal Corporation, district board, and similar entities. A public corporation is established under a specific legislative act. An idol or deity can be regarded as an Artificial Juridical Person, but only through the individuals who manage it. Likewise, all other artificial entities possessing their own juristic personality, such as universities, are classified as artificial persons. For the purposes of section 2(31), an Association of Persons (AOP), Body of Individuals (BOI), local authority, or Artificial Juridical Person shall be considered a person, regardless of whether it was created or established with the intention of generating income, profits, or gains.

### **1.2.15 Assessee [SEC. 2(7)]**

Under the Income Tax Act, an assessee means a person:

- i. who is liable to pay any tax; or
- ii. who is liable to pay any other sum of money under this Act (e.g., interest, penalty, etc.); or
- iii. in respect of whom any proceeding under this Act has been taken for the assessment of his income or assessment of fringe benefits; or
- iv. in respect of whom any proceeding under this Act has been taken for the assessment of the income of any other person in respect of which he is assessable; or
- v. in respect of whom any proceeding under this Act has been taken for the assessment of the loss sustained by him or by such other person; or
- vi. in respect of whom any proceeding under this Act has been taken for the amount of refund due to him or to such other person; or
- vii. who is deemed to be an assessee under any provision of this Act; or
- viii. who is deemed to be an assessee in default under any provision of this Act.



## 1.2.16 Deemed Assessee

An individual considered as an assessee on behalf of another individual is referred to as a 'Deemed Assessee'. For instance, (i) following an individual's demise, their legal representative will be regarded as an assessee for any income of the deceased that remains untaxed prior to their death; (ii) an individual representing a foreign national, a minor, or a person deemed mentally incapacitated is considered an assessee for the income of that foreign national, minor, or mentally incapacitated individual.

## 1.2.17 Assessee in Default

A person who is obligated to perform any task under the Act and fails to do so is referred to as a 'Assessee in Default.' If an individual is obligated to withhold income tax at source while making a payment to another individual, and fails to do so, or if they withhold the tax but do not remit it to the Government Treasury, they will be classified as an assessee in default for that income tax.

## 1.2.18 Maximum Marginal Rate [SEC. 2(29C)]

It refers to the income tax rate (including any applicable surcharge) relevant to the highest income bracket for individuals, Associations of Persons, or Bodies of Individuals as delineated in the Finance Act of the pertinent year.

## 1.2.19 Average Rate of Tax

The tax rate is calculated by summing sources of taxable income and dividing that total by the amount of taxes owed. The rate is determined by dividing the total tax liability by the total taxable income.

## 1.2.20 Liable to Tax [SEC. 2(29A)]

"Liable to tax," pertaining to an individual and connected to a country, signifies that the individual bears an income tax obligation under the prevailing laws of that country, and encompasses individuals who have subsequently been granted an exemption from such obligation under the laws of that country.

## 1.2.21 Company [SEC. 2(17)]

Company means:

- i. any Indian Company; or
- ii. any corporate incorporated by or under the laws of a country outside India; or
- iii. any institution, association, or body that is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act for any assessment year beginning on or before April 1st, 1970, or
- iv. any institution, association, or body, whether incorporated or unincorporated, Indian or non-Indian, that is declared a company by the Board's general or special order.

## 1.2.22 Indian Company [SEC. 2(26)]

The term "Indian company" refers to a company formed and registered under (i) the Indian Companies Act; (ii) any company-related law that was or is in force in any part of India; (iii) a corporation established by or under a Central, State, or Provincial Act; or (iv) an institution, association, or body that the Board declares to be a company. In all cases, the registered office must be in India.

## 1.2.23 Domestic Company [SEC. 2(24)]

It refers to an Indian company or any other company that has made the necessary arrangements for the declaration and payment of dividends on income taxable under the Income Tax Act.

## 1.2.24 Company in which the Public are Substantially-Interested [Sec. 2(18)]

In the following situations, a company is said to be a company in which the public is substantially interested:

- a. It is a company owned by the Government or the Reserve Bank of India, or in which the Government or the Reserve Bank of India holds at least 40% of the shares, or a corporation owned by the R.B.I.; or
- b. It is a company that is registered under Section 8 of the Companies Act of 2013.
- c. It is a company with no share capital that has been declared by order of the Central Board of Direct Taxes to be a company in which the public has a substantial interest.
- d. It is a mutual benefit finance company, i.e., a company that accepts deposits from its members as its primary business and has been declared by the Central Government as a Nidhi or Mutual Benefit Society; or
- e. It is a company where shares carrying at least 50% of the voting power are held by one or more co-operative societies throughout the relevant previous year; or
- f. It is a company that is not a private company under the Companies Act of 2013, and its equity shares were listed on a recognised stock exchange in India as of the last day of the relevant previous year; or
- g. It is a non-private company whose equity shares carrying at least 50% (40% in the case of an industrial company) of the voting power were beneficially held by the government, a statutory corporation, any other company in which the public has a substantial interest, or a wholly owned subsidiary of such a company during the previous year.

**Widely-held Company:** This is the popular name of a company in which the public is very interested.

**Closely-held Company:** This is the popular name of a company in which the public are not substantially interested.



## 1.2.25 Dividend [SEC. 2(22)]

Dividends are typically defined as a company's distribution of profits to its shareholders. The dividend shall also include: (a) Distribution of accumulated profits to shareholders entailing the release of the company's assets; (b) Distribution of debentures or deposit certificates to shareholders out of the accumulated profits of the company and the issue of bonus shares to preference shareholders out of accumulated profits; (c) Distribution made to shareholders of the company on its liquidation out of accumulated profits; (d) Distribution to shareholders out of accumulated profits.

## 1.2.26 Substantial Interest [SEC. 2(22), SEC. 2(32)]

- a. A person is deemed to have a substantial interest in a concern other than a company if, at any time during the previous year, he was beneficially entitled to at least 20% of such concern's income.
- b. A person is deemed to have a substantial interest in a company if he is the beneficial owner of shares that do not have a fixed dividend rate and carry at least 20% of the voting power.
- c. An individual is considered to have substantial interest if he and his relatives beneficially own equity shares with at least 20% voting power in the case of a company, or if the concern is not a company, he and his relatives are entitled to at least 20% of the concern's profits at any time during the previous year.

## 1.2.27 Public Sector Company [SEC. 2(36A)]

It refers to any corporation formed by or under any Central or State Act, or a Government Company as defined in Section 2(71) of the Companies Act, 2013.

## 1.2.28 Foreign Company [SEC. 2(23A)]

A foreign company is one that is not an Indian company and has not made the necessary arrangements for declaring and paying dividends in India.

## 1.2.29 Computation of Total Income and Tax Payable

The following fundamental principles emerge from the charging section:

1. Income tax is an annual tax levied on income.
2. Income from the previous year is taxable in the following assessment year at the applicable rate or rates. However, there are some exceptions to the rule. (Accelerated assessment).
3. Tax rates are fixed by the Annual Finance Act.
4. Tax is charged on every person as defined in section 2(31).
5. The tax is based on a person's total income as determined by this Act.
6. Income tax is to be deducted at the source or paid in advance, as provided by the Act.

The total income is computed on the basis of the assessee's residential status in the manner provided herein and is classified into the following five categories:

1. Income from Salaries
2. Income from House Property
3. Profits and Gains of Business or Profession
4. Capital Gains and
5. Income from Other Sources.

To compute an assessee's total income and the tax payable, the following step-by-step procedure is followed:

1. Classify the income under each of the above five heads, and then deduct the deductions allowed by the Act for that head of income. The remaining amount under each head of income is referred to as assessable income.
2. Gross Total Income is the sum of each head's assessable income added together.
3. Deduct the deductions allowed under sections 80C to 80U of the Act from the Gross Total Income. The remaining balance after subtracting the allowable deductions is referred to as Total Income.
4. The amount of income tax payable is then calculated on this total income using the Finance Act's rates for the relevant assessment year, as well as the rates specified in various sections of the Act.

### **1.2.30 Tax Rates (Normal Tax Regime) Rates of Tax for the Assessment Year 2024-25**

Tax rates for an individual, HUF, AOP (other than a co-operative society), BOI, or any Artificial Juridical Person as prescribed by the Annual Finance Act for the normal tax regime:

- a. Individual-Senior citizen (resident of India aged 60 or older but less than 80 at any time in the previous year):

On ₹ 3,00,000 Nil

Next on ₹ 2,00,000 5%

Next on ₹ 5,00,000 20%

Next-Balance 30%

- b. Individual-Super senior citizen (resident in India, who is of the age of 80 years or more at any time during the previous year):

On ₹ 5,00,000 Nil

Next on ₹ 5,00,000 20%

Next-Balance 30%

c. Other individuals, HUF, AOP or BOI:

On ₹ 2,50,000 Nil

Next on ₹ 2,50,000 5%

Next on ₹ 5,00,000 20%

Next Balance 30%

### **Income Tax Slabs For Fy 2024-25 (Ay2025-26) Under The Old Regime**

There were no changes to the old regime's tax slabs in the 2024 budget. The tax slabs under the previous regime were as follows:

a. Individual-Senior citizen (resident in India, who is of the age of 60 years or more but less than 80 years at any time during the previous year):

On ₹ 3,00,000 Nil

Next on ₹ 2,00,000 5%

Next on ₹ 5,00,000 20%

Next-Balance 30%

b. Individual-Super senior citizen (resident in India, who is of the age of 80 years or more at any time during the previous year):

On ₹ 5,00,000 Nil

Next on ₹ 5,00,000 20%

Next-Balance 30%

c. Other individuals, HUF, AOP or BOI:

On ₹ 2,50,000 Nil

Next on ₹ 2,50,000 5%

Next on ₹ 5,00,000 20%

Next Balance 30%

### **Income Tax Slabs For Fy 2024-25 (Ay2025-26) Under The New Tax Regime**

Table 1.2.3 Income Tax Slabs For Fy 2024-25 (Ay2025-26) Under The New Tax Regime

<b>Income Tax Slabs</b>	<b>Income Tax Rates</b>
Up to Rs. 3 lakh	NIL
Rs. 3 lakh - Rs. 7 lakh	5%
Rs. 7 lakh - Rs.10 lakh	10%
Rs. 10 lakh - Rs.12 lakh	15%
Rs.12 lakh - Rs.15 lakh	20%
Above Rs.15 lakh	30%

The standard deduction for salaried employees is ₹75,000 under the new tax regime. A tax rebate of up to Rs . 25,000 is applicable if the total income does not surpass Rs . 7,00,000. The deduction on family pension has been increased from Rs. 15,000 to Rs. 25,000. The cap on employer contributions to the NPS is 14% for the fiscal year 2024-25. The new regime constitutes the standard tax framework. Individuals opting for the old regime must submit Form 10-IEA. The maximum surcharge rate is 25% under the new regime, compared to 37% in the previous regime.

### **Income Tax Slabs For Fiscal Year 2025-26 (Ay 2026-27)**

According to Budget 2025, individuals earning up to Rs. 12,00,000 will incur no tax liability for FY 2025-26 (AY 2026-27) under the revised tax regime. The revised tax framework pursuant to section 115BAC is addressed in section 202 of the New Income Tax Bill, 2025. Under the amended tax framework, individuals with earnings up to Rs . 12,00,000 will incur no tax obligation owing to the augmented rebate of Rs . 60,000. Salaried individuals will incur no tax liability on incomes up to Rs.12,75,000, attributable to the Rs.75,000 standard deduction. The updated tax brackets are as follows:

Table 1.2.4 Income Tax Slabs For Fiscal Year 2025-26 (Ay 2026-27)

Income Tax Slabs	Income Tax Rates
Upto Rs 4 Lakhs	Nil
Rs 4 Lakh-8 Lakh	5%
Rs.8 lakh - Rs.12 lakh	10%
Rs.12 lakh - Rs.16 lakh	15%
Rs.16 lakh - Rs.20 lakh	20%
Rs.20 lakh - Rs.24 lakh	25%
Above Rs.24 lakh	30%

### **1.2.31 Rebate of Income Tax (Sec. 87A)**

Individuals in India with a total income under ₹ 5,00,000 are eligible for a deduction of up to 12,500 in income tax. The key features of an income tax rebate are as follows:

1. The rebate under Section 87A is only available to residents. HUF/AOP/BOI/ Firm/Company and non-resident individuals are not eligible for a rebate under Section 87A.
2. There is a limit on total income for claiming a rebate under Section 87A. The total income after all deductions, including deductions, should not exceed Rs. 5 lakh. If your total income exceeds ₹ 5 lakh, you will not be eligible for the rebate under Section 87.
3. The total rebate is limited to 12,500. In short, the lower of the actual income tax liability of \$12,500 is deductible under Section 87A.

4. This rebate is available on the tax computed before charging of the Health and Education Cess, which is currently at 4%.

Health and Education Cess: Health and Education Cess of 4% will be levied on the amount of income tax and surcharge.

### 1.2.32 Marginal Relief

The purpose of marginal relief is to ensure that the increase in tax payable (including surcharge) due to an assessee's total income exceeding the prescribed limit does not exceed the amount of increase in total income. There will be no marginal relief on the health and education cess.

### Recap

- ◊ Monetary earnings obtained from specific sources with a degree of consistency or anticipated consistency are income.
- ◊ The company's distribution of profits to its shareholders is a dividend.
- ◊ A company in which the public is not substantially interested is termed a Closely held Company.
- ◊ Individuals with a total income under ₹ 5,00,000 are eligible for a deduction of up to Rs 12,500 in income tax.
- ◊ Health and Education Cess of 4% will be levied on the amount of income tax and surcharge.

### Objective Questions

1. What is money that is regularly earned from particular sources?
2. What are referred to as companies that capture significant public interest?
3. How does a business pay out its earnings to its stockholders?
4. Exactly how many categories of total income can one explore?
5. Could you explain what it means for someone to be taxed in the same year that they earn money?
6. What is the current rate for health and education cess?
7. Current assessment year?
8. Income tax Act Section explain about previous year

## Answers

1. Income
2. Widely held Companies
3. Dividend
4. Five
5. Accelerated Assessment
6. 4%
7. 2025-26
8. Section - 3

## Assignments

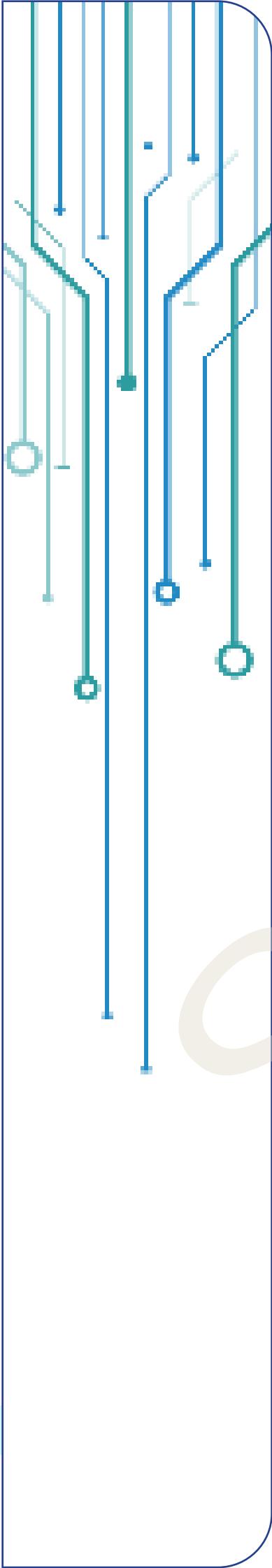
1. Explain the categories that are used to define a "company" in section 2(17) of the Income Tax Act?
2. What is the main feature that defines casual income when compared to other types of income?
3. Discuss the differences between total income and gross total income.
4. Identify the distinction between the previous year and the assessment year.
5. Describe some of your thoughts regarding the Accelerated Assessment.
6. How is total income calculated after determining the gross total income?
7. What are the five categories under which income is calculated according to the Income Tax Act?
8. How is the actual amount of the rebate determined if the total income is below five lakh rupees?
9. What are the key elements that make a distribution to shareholders qualify as a dividend?
10. Explain the scenarios in which the previous years earnings are subject to taxation in the same year in which the income is earned?

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## Suggested Reading

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# Unit 3

## Exempted Income

### Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ develop an understanding of the concept of exempted income
- ◊ equip the learner with the concept of totally exempted income
- ◊ understand the concept of incomes that are part of total income but are exempt from income tax obligations

### Prerequisites

Comprehending exempt income is essential for proficient tax planning and adherence. By identifying exempt incomes, taxpayers can optimise their financial strategies and ensure compliance with tax regulations. Tax-exempt status confers numerous benefits, including the primary advantage of tax exemption, eligibility for deductible contributions, access to grant programs, and exemption from certain regulations. Tax exemption diminishes the taxable income amount. Numerous additional exemptions exist, manifesting in various forms.

### Keywords

Exempted income, Agricultural income, Special Economic Zone

## Discussion

### 1.3.1 Exempted Income (Sec. 10)

Exempt income is income that is not subject to income tax. Some incomes are excluded from total income, while others are included but not taxed.

#### 1.3.1.1 Income that is not included in total income and is not subject to income tax (Totally Exempt) (SEC. 10).

Any income falling under any of the following clauses shall not be included in a person's total income for the previous year and is not taxable.

##### 1. Agricultural Income. [Sec. 10(1)]

Agricultural income is completely exempt from income taxes. However, agricultural income is considered when determining the tax on the non-agricultural income of an individual, Hindu Undivided Family, Association of Persons, or Body of Individuals whose total income (excluding agricultural income) exceeds the minimum taxable limit and agricultural income exceeds Rs 5,000.

##### 2. Sum received from H.U.F: [Sec. 10(2)]

Any sum received by a member of a Hindu Undivided Family from the family's income is tax-exempt. However, the entire income derived from the converted property, as stated in section 64(2), must be included in the income of the member who transferred his individual asset to the family.

##### 3. Share of income of a partner in the firm Sec. 10(2A)

A partner in a firm will be exempt from tax on his share of income in the firm, which will be calculated by dividing the firm's taxable profits in the same proportion as the profit-sharing ratio specified in the partnership deed.

##### 4. Interest received by Non-resident [Sec. 10(4)]

Non-residents are exempt from income from interest on such securities or bonds as the Central Government may specify in this regard prior to 1.6.2002, including income from premiums on the redemption of such bonds.

##### 5. The interest income of a non-resident Indian citizen or person of Indian origin [Sec. 10(4B)]

Income derived from interest on Savings Certificates issued by the Central Government prior to June 1, 2002, as specified in the Official Gazette, is exempt from taxation. The issuance of National Savings Certificate VI and VII has been announced for this purpose. This exemption will be granted solely if the individual has acquired such certificates using convertible foreign exchange remitted from abroad. The exemption will be accessible solely to the initial subscribers of the Savings Certificate. An individual is considered of Indian origin if he, one of his parents, or any of his grandparents was born in undivided India.

## **6. Interest payable to a non-resident/foreign company [Sec. 10(4C)]**

Interest owed to a non-resident or foreign entity by an Indian company or business trust concerning funds acquired from an external source through the issuance of rupee-denominated bonds between September 17, 2018, and March 31, 2019.

## **7. Any income accrued or arisen to, or received by a specified fund [Sec. 10(4D)]**

Any income generated or received by a specified fund from the transfer of a capital asset on a recognised stock exchange in any International Financial Services Centre, to the extent that such income is related to units held by a non-resident or is attributable to the investment division of an offshore banking unit.

## **8. Any income accrued or arisen to, or received by, a non-resident [Sec. 10(4E)]**

Any income generated or received by a non-resident from the transfer of non-deliverable forward contracts of offshore derivative instruments or over-the-counter derivatives, or (effective from the assessment year 2024-25) from the distribution of income on offshore derivative instruments executed with an offshore banking unit of an International Financial Services Centre, provided that specified conditions are met.

## **9. Any income of a non-resident by way of royalty [Sec. 10(4F)]**

Any income of a non-resident derived from royalties due to the lease of an aircraft or ship in a preceding year, disbursed by a unit of an International Financial Services Centre, provided that the unit qualifies for a deduction under section 80LA for that preceding year and has commenced operations on or before March 31, 2025.

## **10. Any income received by a non-resident from a portfolio of securities/financial products/funds[Sec. 10(4G)]**

Income obtained by a non-resident from a portfolio of securities, financial products, or funds managed by a portfolio manager on behalf of the non-resident, or (effective from the assessment year 2024-25) income derived from such activities as designated by the Central Government, in an account held with an Offshore Banking Unit in any International Financial Services Centre, is considered to accrue or arise outside India and is not deemed to accrue or arise within India.

## **11. Any income of a non-resident or a Unit of an International Financial Services Centre [Sec. 10(4H)]**

Income derived by a non-resident or a unit of an International Financial Services Centre, primarily engaged in aircraft leasing, from capital gains resulting from the transfer of equity shares of a domestic company that is also a unit of an International Financial Services Centre engaged in aircraft leasing, which commenced operations on or before March 31, 2026 (effective from the assessment year 2024-25).

## **12. Leave Travel Concession to an Employee [Sec. 10(5)]**

## **13. Receipts in the case of an individual who is not a citizen of India [Sec. 10(6)]**

## **14. Salary received by a foreign citizen [Sec. 10(6)(vi)]**

Compensation earned by a foreign national employed by a foreign entity, contingent upon their duration of stay in India not surpassing 90 days.

## **15. Salary received by a non-resident foreign citizen [Sec. 10(6)(viii)]**

Salary earned by a non-resident foreign national who is a member of a ship's crew is exempt, provided their total duration of stay in India does not exceed 90 days.

## **16. Remuneration received by an employee [Sec. (6)(xi)]**

Compensation received by an employee who is a foreign national, representing a foreign government, assigned to India for training in a government establishment or public sector undertaking.

## **17. Tax paid by Government or an Indian Concern[Sec. 10(6A)]**

The tax remitted by the Government or an Indian entity on behalf of a foreign corporation concerning royalties or fees for technical services rendered by the foreign entity, pursuant to an agreement aligned with the Government of India's Industrial Policy, shall not be factored into the total income of the foreign corporation. In other instances, to obtain this exemption, the agreement must receive approval from the Central Government. The agreement must be executed between 31 March 1976 and 1 June 2002.

## **18. Tax paid by Government or an Indian Concern [Sec. 10(6B)]**

The tax remitted by the Government or an Indian entity on behalf of a non-resident (excluding companies) or a foreign company concerning its income (excluding salary, royalty, or technical service fees) from the Government or an Indian entity will not be factored into the total income of the non-resident or foreign company. The exemption will be accessible solely:

- a. where such income arises from an agreement established between the Central Government and the Government of a foreign State or an International Organisation prior to 1.6.2002, and
- b. (b)The tax is remitted in accordance with the stipulations of that agreement or any associated agreement sanctioned by the Central Government prior to June 1, 2002.

## **19. Tax paid by an Indian Company on behalf of a foreign state or foreign enterprise[Sec. 10(6BB)]**

Tax remitted by an Indian Company on behalf of a foreign State or foreign enterprise for income derived from leasing an aircraft or an aircraft engine shall be exempt, contingent upon the agreement being executed (i) after 31.3.1997 but before 1.4.1999, or (ii) after 31.3.2007, and receiving approval from the Central Government.

## **20. Income of a foreign company by way of royalty or fees for technical services [Sec. 10(6C)]**

The revenue of a foreign entity, as designated by the Central Government, derived from royalties or fees for technical services received under an agreement with the Central Government for providing services related to projects associated with India's security, whether conducted within or outside India.

## **21. Royalty or fees for technical services received from National Technical Research Organisation (NTRO) [Sec. 10(6D)]**

Income generated for non-corporate non-residents and foreign companies through royalties or fees for technical services provided to the National Technical Research Organisation (NTRO), either within or outside India.

## **22. Allowances or Perquisites outside India [Sec. 10(7)]**

## **23. Death-cum-retirement Gratuity [Sec. 10(10)]**

## **24. Commutation of Pension [Sec. 10(10A)]**

## **25. Leave Salary or Encashment of Earned Leave [Sec. 10(10AA)]**

## **26. Compensation on Retrenchment [Sec. 10(10B)]**

## **27. Any payments made under the Bhopal Gas Leak Disaster Act, 1985 [Sec. 10(10BB)]**

Payments received by an individual will be tax-exempt; however, any payment for which a deduction has previously been granted will not qualify for exemption.

## **28. Compensation on any disaster[Sec. 10(10BC)]**

Any compensation received or receivable by an individual or their legal heir from the Central Government, a State Government, or a local authority due to a disaster shall be exempt from taxation. Nonetheless, the amount permitted as a deduction under this Act for any loss or damage resulting from such a disaster shall not be exempt.

## **29. Compensation on Voluntary Retirement [Sec. 10(10C)]**

## **30. Tax paid by Employer on the value of perquisites [Sec. 10(10CC)]**

## **31. Any sum received under a Life Insurance Policy[Sec. 10(10D)]**

All proceeds received from a life insurance policy, including bonuses, are exempt from taxation. The following points should be acknowledged in this context:

- ◊ Exemption applies solely to amounts received from life insurance policies.
- ◊ Exemption under section 10(10D) is unequivocally applicable to sums received from policies issued on or before March 31, 2003. For policies issued on or after April 1, 2003, the exemption is applicable only if the premium paid in any financial year does not surpass 20% (10% for policies taken on or after April 1, 2012) of the actual capital sum assured. Effective from April 1, 2013, for policies issued in the name of individuals afflicted with diseases enumerated under section 80DDB or disabilities outlined in section 80U, the limit will be raised to 15% of the capital sum assured.
- ◊ The value of any premium agreed to be refunded or any benefit received as a bonus (or otherwise), in addition to the sum assured, shall not be considered when calculating the actual capital sum assured under the policy.
- ◊ The sum received upon the individual's demise will remain exempt unconditionally.

- ◊ No exemption shall apply to any amount received under section 80DD(3) or from a Keyman insurance policy.

For the Assessment Year 2021-22, any amount received from a Unit Linked Insurance Plan (ULIP) is not eligible for exemption if the ULIP was issued on or after February 1, 2021, and the premium paid in any preceding year during the policy's term exceeds ₹2,50,000. Moreover, if an individual pays premiums for multiple ULIPs issued on or after February 1, 2021, the exemption under Section 10(10D) will apply to those ULIPs, provided the total premium amount does not surpass ₹2,50,000 in any previous year throughout the duration of any of those policies.

- ◊ With effect from Assessment, in the fiscal year 2024-25, no exemptions will apply to life insurance policies (excluding ULIPs) issued on or after April 1, 2023, if the annual premium exceeds five lakhs. Moreover, if an individual pays premiums for multiple life insurance policies, the exemption will apply solely to those policies (excluding ULIPs) where the total premium amount does not surpass 5 lakhs in any of the preceding years throughout the duration of any of those policies.
- ◊ The aforementioned shall not be applicable in instances where the amount is received upon an individual's demise.

32. Payment from Statutory Provident Fund [Sec. 10(11)]

33. Any payment from the Sukanya Samridhi Account. [Sec. 10(11A)]

34. Payment from Recognised Provident Fund [Sec. 10(12)]

**35. Payment from National Pension System Trust [Sec. 10(12A)]**

Any disbursement from the National Pension System Trust to an assessee upon account closure or opting out of the pension scheme (as delineated in Sec. 80CCD), up to 60% of the total sum payable, shall be exempt from taxation.

**36. Partial withdrawal from National Pension System Trust[Sec. 10 (12B)]**

An employee's partial withdrawal from the National Pension System Trust, in accordance with the stipulations of the Pension Fund Regulatory Development Authority Act, 2013, and its associated regulations, shall be exempt up to 25% of the contributions made by the employee.

**37. Exemption for amount received by a person enrolled in the Agnipath Scheme 2022 or his nominee from the Agniveer Corpus Fund [Sec. 10(12C)]**

38. Payment from Approved Superannuation Fund [Sec. 10(13)]

39. House Rent Allowance [Sec. 10(13A)]

40. Special Allowance for meeting certain expenditure [Sec. 10(14)]

41. Interest of different types [Sec. 10(15)]

The subsequent interests are entirely exempt from taxation:

- i. Interest and premium upon the redemption of designated securities, bonds, or certificates, such as.

- a. National Defence Gold Bonds, 1980,
- b. Special Bearer Bonds, 1991,
- c. Post Office Cash Certificates (5 Years),
- d. P.O. Savings Bank Account,
  - i. Individual account-Maximum exemption limit ₹ 3,500.
  - ii. Joint account-Maximum exemption limit ₹7,000.
- e. P.O. Cumulative Time Deposit Account,
- f. Public Account of P.O. Savings Account Rules (interest up to ₹ 5,000), and
- g. Special Deposit Scheme, 1981 and Non-resident (Non-repatriable) Rupee Deposit Scheme.

- ii. For an individual or Hindu Undivided Family (H.U.F): Interest on 7% Capital Investment Bonds announced in the Official Gazette by the Central Government prior to June 1, 2002.
- iii. Interest on bonds that were announced prior to June 1, 2002, and accruing to:
  - a. An individual non-resident Indian who possesses the bonds, such as N.R.I. Bonds, 1988, issued by the State Bank of India; or
  - b. any individual who holds the bonds as a nominee or survivor of the non-resident Indian; or (c) any individual who receives the bonds as a gift from the non-resident Indian.

The aforementioned exemption shall be granted provided that the subsequent conditions are met:

- a. A non-resident Indian acquires bonds using foreign exchange.
- b. Interest and principal received from such bonds, whether upon maturity or otherwise, cannot be remitted out of India.
- c. If a non-resident Indian individual attains resident status in India in a subsequent year, the exemption benefit will persist.
- d. If the Bonds are redeemed prior to maturity, the exemption will not apply for the assessment year corresponding to the previous year in which the Bonds were redeemed.

- iv. Interest payable to any foreign bank executing central banking functions within that country on deposits made with any scheduled bank.
  - iv(a). Interest owed to the Nordic Investment Bank on a loan provided for a project sanctioned by the Central Government, as per the Memorandum of Understanding established with the Bank on November 25, 1986.
  - iv(b). Interest owed to the European Investment Bank on a loan provided under the financial cooperation framework agreement established on November 25, 1993, by the Central Government with the bank.
- v. Interest payable
  - a. by the Government or local authority on funds borrowed prior to June 1, 2001, from external sources;

- b. by an industrial undertaking in India on funds borrowed under an agreement established before June 1, 2001, from a foreign financial institution.
- c. by an industrial enterprise in India regarding any funds borrowed prior to June 1, 2001, from a foreign nation for the acquisition of raw materials or machinery outside India.
- d. by the Industrial Finance Corporation of India, the Industrial Development Bank of India, the Export-Import Bank of India, the National Housing Bank, the Small Industries Development Bank of India, or the Industrial Credit and Investment Corporation of India on loans obtained by them in foreign countries prior to June 1, 2001.
- e. by any other financial institution in India or by an Indian bank on loans obtained from foreign countries prior to June 1, 2001, intended for providing advances to industrial enterprises in India for the acquisition of raw materials or machinery abroad.
- f. by an industrial enterprise in India utilising funds borrowed in foreign currency from international sources under a loan agreement sanctioned by the Central Government prior to June 1, 2001, to address the requirements of industrial development in India.
  - f(a). A scheduled bank may accept deposits in foreign currency from a non-resident or a not ordinarily resident, contingent upon approval from the Reserve Bank of India.
- g. by an Indian public company established primarily to furnish long-term financing for the construction or acquisition of residential properties in India, concerning any funds borrowed in foreign currency from international sources under a loan agreement sanctioned by the Central Government prior to June 1, 2003.
- h. by any public sector enterprise concerning such bonds or debentures as may be notified by the Central Government, for instance, HUDCO, REC, NTPC.
  - i. by the Government on deposits made by a retired employee of the Government or a public sector enterprise, derived from the funds owed to him upon retirement, whether due to superannuation or other reasons. These deposits will be secured for duration of three years.
- vi. Interest on Securities held by the Welfare Commissioner for the Bhopal Gas Victims in the Reserve Bank of India: Compensation for the Bhopal Gas Tragedy victims has been deposited in the Reserve Bank of India as Central Government Securities under the name of the Welfare Commissioner for the Bhopal Gas Victims.
- vii. Interest accrued on deposits with the Reserve Bank of India or a designated public sector bank, maintained for the benefit of the victims of the Bhopal gas leak disaster.
- viii. Interest on Gold Deposit Bonds issued under the Gold Deposit Scheme of 1999 or on deposit certificates issued under the Gold Monetisation Scheme of 2015, as notified by the Central Government.

- ix. Interest on bonds (a) issued by a local authority or a State Pooled Finance Entity, and (b) designated by the Central Government through notification.
- x. Interest accrued to a non-resident or an individual not ordinarily resident in India on deposits made subsequent to May 31, 2005, in an Offshore Banking Unit.

#### **42. Payment by an Indian Company [Sec. 10(15A)]**

Payments made by an Indian Company involved in aircraft operations to lease an aircraft or aircraft engine from a foreign government or non-resident foreign entity, under an agreement executed (i) prior to April 1, 1997, or (ii) between April 1, 1999, and April 1, 2007, with approval from the Central Government, are entirely exempt. Payments for the provision of spare parts, facilities, or services related to the operation of leased aircraft shall not be exempt.

#### **43. Educational Scholarship [Sec. 10(16)]**

Scholarships awarded to cover educational expenses, whether by governmental bodies or other organisations, are entirely exempt.

#### **44. Allowances of M.Ps. M.L.As. and M.L.Cs. [Sec. 10(17)]**

- i. Daily allowances (Entire amount is fully exempt);
- ii. All other allowances received by any Member of Parliament (the total amount is entirely exempt); and
- iii. Any constituency allowance received by any individual due to their membership in any State Legislature pursuant to any Act or regulations established by that State Legislature.

#### **45. Awards: Any payment made, whether in cash or in kind [Sec. 10(17A)]**

- i. Any award established in the public interest by the Central Government, any State Government, or any other entity sanctioned by the Central Government for this purpose, or
- ii. any reward granted by the Central Government or any State Government for purposes approved by the Central Government in the public interest is entirely exempt. The Central Government has sanctioned the Swatantrata Sainik Pension Scheme, 1980, pursuant to clause (ii).

#### **46. Pension to gallantry awardees [Sec. 10(18)]**

#### **47. Family pension of a member of the armed forces [Sec. 10(19)]**

The family pension granted to the widow or nominated heirs of a member of the armed forces (including paramilitary forces) of the Union, whose death occurred during operational duties, shall be exempt, contingent upon the fulfillment of specified conditions.

#### **48. Annual value of one palace of the Rulers of Indian States [Sec. 10(19A)]**

The yearly valuation of a palace occupied by a Ruler of an Indian State is entirely exempt from taxation. If a section of the palace is rented, he would be eligible to claim an exemption for the entire palace.

## 49. Income of a Local Authority [Sec. 10(20)]

The income of a local authority that is taxable under (i) 'Income from House Property', (ii) 'Capital Gains', (iii) 'Income from Other Sources', or (iv) from a business it conducts, which derives from the provision of goods, or (v) services (excluding water or electricity) within its jurisdiction, or from the supply of water or electricity both within and outside its jurisdiction, is entirely exempt. A local authority refers to (i) a Panchayat; (ii) a Municipality; (iii) a Municipal Committee and District Board, which are legally authorized or designated by the Government to oversee or manage a Municipal or local fund; or (iv) a Cantonment Board.

## 50. Income of Research Association [Sec. 10(21)]

All income of a research association sanctioned under section 35(1)(ii) or 35(1)(iii) is entirely exempt, contingent upon the fulfillment of the following conditions:

- i. The Association employs its income or accumulates it solely for the purposes for which it was established. The stipulations of sections 11(2) and (3) shall pertain to the aforementioned accumulation.
- ii. The association has not allocated or deposited its funds at any point during the preceding year in any manner except as stipulated in section 11(5). The funds shall exclude (a) assets possessed by the association, institution, fund, or trust constituting its corpus as of June 1, 1973, along with any subsequent accretions in the form of bonus shares, (b) debentures obtained prior to March 1, 1983, and (c) voluntary contributions retained in the form of jewellery, furniture, or any other item as designated by the Board.
- iii. Exemption shall not be refused concerning voluntary contributions (excluding cash or contributions in the form of jewellery, furniture, or any other specified article) if such contributions are not retained by the assessee in any form other than those delineated in section 11(5) after the lapse of one year from the conclusion of the previous year in which the asset was acquired.
- iv. Exemption will not apply to any income of research associations (specifically profits and gains from business) unless the business is ancillary to the fulfillment of its objectives and distinct financial records are maintained for such business activities.

## 51. Income of professional institutes [Sec. 10(23A)]

Any income, excluding 'Income from House Property,' remuneration for specific services, or interest and dividends from investments, generated by an association or institution established in India for the purpose of overseeing, regulating, or promoting the professions of law, medicine, accountancy, engineering, architecture, or any other profession as periodically notified by the Central Government in the Official Gazette.

The income is exempt only if the following conditions are met:

- i. The association or institution utilises its income or accumulates it exclusively for its objectives; and
- ii. The association or institution receives approval from the Central Government for this clause.

## **52. Income of Regimental Fund or Non-Public Fund [Sec. 10(23AA)]**

Income generated by any Regimental Fund or Non-Public Fund established by the Union's armed forces for the welfare of current and former members and their dependents is entirely exempt from taxation.

## **53. Income of a fund for the welfare of employees or their dependents [Sec. 10(23AAA)]**

The income of a designated fund created for the benefit of employees or their dependents, provided that these employees are also members of the fund, shall be exempt if the subsequent conditions are met:

- i. The fund utilises its income or accumulates it solely for the purposes for which it was established.
- ii. The fund allocates its resources, contributions, and other amounts received as stipulated in section 11(5).
- iii. The fund is approved by the Commissioner. Approval cannot be granted simultaneously for more than three Assessment Years.

## **54. Income of Pension Fund set-up by L.L.C. of India or other insurer [Sec. 10(23AAB)]**

Income generated by a fund established by the Life Insurance Corporation of India on or after 1st August 1996, under a pension scheme, or by any other insurer under a pension scheme to which contributions are made by an individual for the purpose of receiving a pension from such fund, and which is sanctioned by the Controller of Insurance or the Insurance Regulatory and Development Authority, shall be exempt from Income Tax.

## **55. Income of Khadi and Village Industries [Sec. 10(23B)]**

The revenue of an institution formed as a trust or society aimed at the development of Khadi and Village Industries (non-profit) derived from the production, sale, or marketing of Khadi or Village Industry products is entirely exempt. The exemption will be granted only if the institution utilises its income or accumulates it exclusively for the advancement of Khadi and Village Industries. Moreover, these institutions will qualify for this exemption solely if they receive approval for this clause from the Khadi and Village Industries Commission. The Commission will possess the authority to grant approval to such institutions for a duration of three assessment years at once.

## **56. Income of Khadi and Village Industries Board [Sec. 10(23BB)]**

The revenue generated by Khadi and Village Industries Boards, established in a State through a State or Provincial Act for the advancement of Khadi or Village Industries, is entirely exempt from taxation.

## **57. Income of a statutory authority for the administration of public religious or charitable trusts [Sec. 10(23BBA)]**

The income of any entity or authority established under any statute for the management of public religious or charitable trusts or endowments (including Mathas,

temples, gurdwaras, wakfs, churches, or other places of public religious ownership or societies for religious or charitable purposes) is entirely exempt from taxation. This provision explicitly states that the exemption does not apply to the income of any trust, endowment, or society.

### **58. Income of European Economic Community [Sec. 10(23BBB)]**

Income generated by the European Economic Community in India through interest, dividends, or capital gains from investments made with its funds under a designated scheme is exempt from taxation.

### **59. Income of SAARC Fund [Sec. 10(23BBC)]**

All income generated by the South Asian Association for Regional Cooperation Fund for Regional Projects established under the Colombo Plan Declaration shall be exempt from taxation.

60. Any income of the Insurance Regulatory and Development Authority shall be exempt. [Sec. 10(23BBE)]
61. Any income of the Central Electricity Regulatory Commission shall be exempt. [Sec. 10(23BBG)]
62. Any income of the Prasar Bharati (Broadcasting Corporation of India) shall be exempt [Sec. 10(23BBH)]

### **63. Income of Specified Charitable Funds [Sec. 10 (23C)]**

The income from the subsequent funds or trusts is entirely exempt.

- i. The Prime Minister's National Relief Fund or the Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES FUND); or
- ii. The Prime Minister's Fund (Promotion of Folk Art); or
- iii. The Prime Minister's Aid to Student Funds; or
- iiia. The National Foundation for Communal Harmony, or
- iiiaa. The Swachh Bharat Kosh; or
- iiiaaa. The Clean Ganga Fund; or
- iiiaaaa. The Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund;
- iiab. Any university or educational institution established exclusively for educational objectives and not for profit, which is entirely or predominantly funded by the Government; or
- iiiac. Any hospital or institution designated for the admission and treatment of individuals afflicted with illness or mental deficiencies, or for the care of individuals during convalescence or those in need of medical attention or rehabilitation, established exclusively for philanthropic objectives and not for profit, and which is entirely or predominantly funded by the Government; or
- (iiiad) Any university or educational institution established exclusively for educational objectives and not for profit, provided that the total annual revenue of such university or educational institution does not surpass five crore rupees, or

- iiiae. Any hospital or institution designated for the reception and treatment of individuals afflicted with illness or mental deficiencies, or for the care of individuals during convalescence or those in need of medical attention or rehabilitation, established exclusively for philanthropic purposes and not for profit, provided that the total annual revenue of such hospital or institution does not surpass 5 crore.
- iv. Any additional fund or institution established for charitable purposes that may receive approval from the designated authority, considering the objectives of the fund or institution and its significance across India or within specific States;
- v. Any trust or institution established exclusively for public religious purposes or for public religious and charitable purposes, which may receive approval from the designated authority, considering the administration and oversight of the trust or institution to ensure that the income generated is appropriately utilised for its intended objectives;
- vi. Any university or educational institution established exclusively for educational purposes and not for profit, excluding those specified in sub-clause (iiiab) or sub-clause (iiiad), which may receive approval from the designated authority or
  - via. Any hospital or institution designated for the reception and treatment of individuals afflicted with illness or mental deficiencies, or for the care of individuals during convalescence or those in need of medical attention or rehabilitation, established exclusively for philanthropic purposes and not for profit, except as specified in sub-clause (iiiac) or sub-clause (iiiae), and which may receive approval from the designated authority.

#### **64. Income of Investor Protection Fund from recognised stock exchange [Sec. 10(23EA)]**

The income generated by Funds established by recognised stock exchanges in India, whether collectively or individually, is exempt. The revenue is generated from contributions received from recognised stock exchanges and their members. If any amount credited to the Fund and not previously subject to income tax is partially or wholly distributed to a recognised stock exchange, the entire amount shared shall be considered income for the previous year in which the distribution occurs and shall be subject to income tax.

#### **65. Income of Investor Protection Fund from commodity exchanges [Sec. 10(23EC)]**

Any income derived from contributions received from commodity exchanges and their members for the Investor Protection Fund established by the commodity exchanges in India, whether collectively or individually, as notified by the Central Government, shall be exempt. If any amount credited to the Fund and not subject to income tax in prior years is partially or wholly distributed to a commodity exchange, the entire amount shared shall be considered income for the previous year in which the distribution occurs and shall be liable for income tax accordingly.

**66. Any income by way of contributions received from a depository of such Investor Protection Fund set up by a depository shall be exempt. [Sec. 10(23ED)]**

If any amount in the Fund, not previously subject to income tax, is partially or wholly distributed to a depository, that amount shall be considered income for the previous year in which it was distributed and subject to income tax.

**67. Any income by way of dividends or long-term capital gains of Venture Capital Fund or a Venture Capital Company (Sec. 10(23FA)]**

A 'venture capital fund' refers to a fund created by trustees to raise capital primarily for the purpose of investing in equity shares of a venture capital undertaking, in compliance with established guidelines. A venture capital company is defined as an entity that invests by acquiring equity shares in venture capital undertakings in compliance with established guidelines. A 'venture capital undertaking' refers to a domestic company whose shares are not publicly listed on a recognised exchange. Income derived from dividends (excluding those specified in Sec. 115-0) or long-term capital gains of a venture capital fund or venture capital company from equity investments in a venture capital undertaking shall be exempt if:

- i. It is approved by the Central Government on an application made by the assessee.
- ii. The undertaking is engaged in the:
  - a. enterprises engaged in software and information technology; the production of essential pharmaceuticals in the pharmaceutical industry, biotechnology, agriculture, and related sectors, or any other sectors as may be designated by the Central Government, or
  - b. the production or manufacture of any article or substance for which a patent has been awarded to the National Research Laboratory or any other scientific research institution sanctioned by the Department of Science and Technology.

**68. Income of Venture Capital Fund or Venture Capital Company [Sec. 10(23FB)]**

Income generated by a venture capital company or fund from investments in a venture capital undertaking shall be exempt from taxation.

**69. Income of Business Trust [Sec. 10(23FC)]**

Revenue of a Business Trust derived from

- i. interest received or receivable from a special purpose vehicle or
- ii. dividends received or receivable from a special purpose vehicle. [effective from Assessment Year 2017-18 to Assessment Year 2020-21]. Only the dividend specified under section 1150(7) is exempt. A special purpose vehicle refers to an Indian company in which a business trust possesses a specific percentage of shareholding or interest, as mandated by the regulations governing the trust's registration. A Business Trust refers to a trust that is registered as either an Infrastructure Investment Trust or a Real Estate Investment Trust.

## **70. Income of a unit holder[Sec. 10(23FD)]**

Any distributed income received by a unit holder from the business trust, corresponding to the income (interest) specified in Sec. 10(23FC) or Sec. 10(23FCA), shall be exempt from taxation.

## **71. Income of specified person in nature of dividend, interest or long-term capital gains arising from investment made in India [Sec. 10(23FE)]**

Any income of a designated individual, including dividends, interest, amounts specified in clause (xii) of section 56(2), or long-term capital gains from investments in India—whether in debt, equity, or units—is exempt. The exemption is accessible if the designated entity meets certain conditions.

## **72. Any Income of the nature of Capital Gains, earned by a non-resident or a specified fund [Sec. 10(23FF)]**

Any capital gains income, generated or received by a non-resident or a specified fund, resulting from the transfer of shares of an Indian resident company by the resultant fund or a specified fund, is attributable to units held by a non-resident (excluding a permanent establishment of a non-resident in India), provided that such shares were transferred from the original fund to the resultant fund during relocation, and where capital gains on those shares would not have been subject to taxation had the relocation not occurred. Income categorised under 'Income from House Property' and 'Income from Other Sources' generated by

- i. a registered trade union, whether representing employers or employees, established primarily to mediate relations between workers and employers or among workers; and
- ii. an association of registered trade unions shall be exempt from income tax.

## **73. Income of Provident Funds, etc. [Sec. 10(25)]**

The subsequent incomes are entirely exempt under this provision:

- i. Interest on securities possessed by a Statutory Provident Fund and Capital Gains resulting from the disposal of such securities; or
- ii. The income obtained by the trustees on behalf of a Recognised Provident Fund, an Approved Superannuation Fund, or an Approved Gratuity Fund; or
- iii. The revenue generated by the Board of Trustees established under the Coal Mines Provident Fund Act of 1948 and the Employees' Provident Fund Act of 1952, pertaining to the Deposit-linked Insurance Fund.

## **74. Income of the Employees' State Insurance Fund is exempt [Sec. 10(25A)]**

## **75. Income of a member of Scheduled Tribes [Sec. 10(26)]**

The earnings of individuals belonging to scheduled tribes living in designated tribal regions or in the States of Arunachal Pradesh, Manipur, Mizoram, Nagaland, Tripura, Sikkim, or the Ladakh region of Jammu & Kashmir, derived from any source within these tribal areas or States, including dividends or interest on securities, are entirely exempt from taxation.

## **76. Income of a Sikkimese individual [Sec. 10(26AAA)]**

The subsequent incomes of an individual classified as Sikkimese shall be exempt.

- i. Revenue from any origin within the State of Sikkim; or
- ii. Revenue in the form of dividends or interest on securities.

## **77. Income of an agricultural marketing committee or board [Sec. 10(26AAB)]**

Any revenue generated by an agricultural produce market committee or board established under any legislation to regulate the marketing of agricultural products.

## **78. Income of a body for promoting the interest of Scheduled Castes or Scheduled Tribes [Sec. 10(26B)]**

The revenue of a corporation created by a Central, State, or Provincial Act, or any other entity, institution, or association entirely funded by the government, established to advance the interests of members of the Scheduled Castes, Scheduled Tribes, or Backwards Classes, is completely exempt.

## **79. Income of Corporation set-up for the benefit of minority community [Sec. 10(26BB)]**

Any income generated by a corporation established by the Central Government or any State Government to advance the interests of members of a minority community shall be exempt from taxation. Minority communities include (i) Muslims, (ii) Christians, (iii) Sikhs, (iv) Buddhists, and (v) Parsis.

## **80. Income of a Corporation[Sec. 10(26BBB)]**

All income generated by a corporation established under a Central, State, or Provincial Act for the welfare and economic advancement of ex-servicemen who are citizens of India shall be exempt from taxation.

An ex-serviceman is defined as

- i. an individual who has served in any capacity, either as a combatant or non-combatant, in the armed forces of the Union or the armed forces of the Indian States prior to the enactment of the Constitution, for a continuous duration of no less than six months following attestation, and who has been released, except through dismissal or discharge due to misconduct or inefficiency. This exclusion pertains to the Assam Rifles, Defence Security Corps, General Reserve Engineering Force, Lok Sahayak Sena, Jammu and Kashmir Militia, and Territorial Army.
- ii. In the event of a deceased or incapacitated ex-serviceman, the term encompasses his spouse, offspring, father, mother, minor brother, widowed daughter, and widowed sister, all of whom were wholly dependent on him immediately prior to his death or incapacitation.

## **81. Income of a Co-operative Society formed for promoting the interests of Scheduled Castes or Scheduled Tribes [Sec. 10(27)]**

The revenue of a cooperative society established to advance the interests of Scheduled Castes or Scheduled Tribes is entirely exempt from taxation.

## **82. Income of Coffee Board, Rubber Board, etc. [Sec. 10(29A)]**

Any income generated or derived by the following shall be exempt:

(a) The Coffee Board; (b) The Rubber Board; (c) The Tea Board; (d) The Tobacco Board; (e) The Marine Products Export Development Authority; (f) The Agricultural and Processed Food Products Export Development Authority; (g) The Spices Board; (h) The Coir Board.

## **83. Subsidy from Tea Board [Sec. 10(30)]**

For an assessee engaged in the cultivation and production of tea in India, any subsidy received from or via the Tea Board for the replantation or replacement of tea bushes, or for the rejuvenation or consolidation of tea cultivation areas, is exempt from taxation. The exemption will be granted only if the assessee submits a certificate from the Tea Board, indicating the amount of subsidy received during the previous year, along with their return for the relevant Assessment Year (or within the extended timeframe permitted by the Assessing Officer).

## **84. Subsidy received by planters [Sec. 10(31)]**

Any subsidy received by an assessee involved in the cultivation and production of rubber, coffee, cardamom, or other designated commodities in India, from or via the Rubber Board, Coffee Board, Spices Board, or any relevant Board concerning any other commodity under any replantation or replacement scheme for rubber, coffee, cardamom, or other plants, or for the rejuvenation or consolidation of areas utilised for the cultivation of such commodities, shall be exempt.

## **85. Income of a minor child[Sec. 10(32)]**

An individual whose income incorporates that of their minor child or children is entitled to an exemption of either the actual amount or ₹ 1,500 for each minor child, whichever is lesser.

## **86. Capital gains on transfer of a unit of Unit Scheme 64 [Sec. 10(33)]**

Any revenue derived from the transfer of a unit of the Unit Scheme, 1964 of the Unit Trust of India, occurring on or after April 1, 2002. The exemption benefit is accessible to an investor, not to an individual possessing a unit as inventory for business purposes.

## **87. Income arising to a shareholder on account of the buy-back of shares by the domestic company shall be exempt. [Sec. 10(34A)]**

## **88. Dividend income of a unit of any IFSC [Sec. 10(34B)]**

Dividend income from a unit of an International Financial Services Centre, primarily involved in aircraft leasing, originating from a company that is also a unit of any International Financial Services Centre engaged in aircraft leasing.

## **89. Any income by way of distributed income received before 1.6.2016 from a securitisation trust by an ancestor of the said trust shall be exempt. [Sec. 10(35A)]**

## **90. Income from transfer of eligible equity shares [Sec. 10(36)]**

Any income generated from the transfer of a long-term capital asset, specifically eligible equity shares in a company acquired between 28.2.2003 and 1.3.2004 and retained for a duration of twelve months or longer.

## **91. Capital gains in case of compulsory acquisition of urban agricultural land [Sec. 10(37)]**

Capital gains resulting from the transfer of agricultural land located in an urban area shall be exempt, contingent upon the following conditions:

- i. The agricultural land is possessed by an individual or a Hindu Undivided Family (HUF).
- ii. The agricultural land was utilised for agricultural purposes by the HUF, an individual, or their parent during the two years immediately prior to the date of transfer.
- iii. The land transfer occurs through compulsory acquisition pursuant to any legislation, or a transfer where the compensation is established by the Central Government or the Reserve Bank of India.

This income has originated from the compensation or consideration (including increased compensation or consideration) for the transfer received on or after April 1, 2004.

## **92. Tax Incentive for Development of Capital of Andhra Pradesh [Sec. 10 (37A)]**

An individual or Hindu Undivided Family (HUF) that possessed a capital asset on June 2, 2014. The taxpayer conveys the capital asset pursuant to the Andhra Pradesh Capital City Land Pooling Scheme. If the reconstituted plot or land received by the assessee in exchange for a capital asset under the scheme is transferred within two years from the conclusion of the financial year in which possession was granted, the capital gains will be exempt.

**Capital asset:** It includes Land or building or both; or the land pooling ownership certificate granted to the assessee under the scheme pertains to land, a building, or both.

## **93. Income from international sporting event [Sec. 10(39)]**

Any designated income (communicated by the Central Government) generated from an international sporting event conducted in India shall be exempt, provided the following conditions are met:

1. The sporting event is sanctioned by the international governing body for the respective sport.
2. More than two nations have engaged in the sporting event.

## **94. Income of Subsidiary Company [Sec. 10(40)]**

Any income received by a subsidiary company, whether as a grant or otherwise, from an Indian holding company involved in the generation, transmission or distribution of power shall be exempt if:

- i. The income received pertains to the settlement of obligations related to the reconstruction or revitalization of an existing power generation business; (ii) The Indian company was established prior to 30.11.2005 with predominant equity involvement from public sector enterprises and was officially recognised by the Central Government before 31.12.2005.

### **95. Specified Income of a Body or Authority [Sec. 10(42)]**

Specified income refers to the income of a particular nature and to a certain extent, generated by the entity or authority that the Central Government may designate for this purpose. Any designated revenue generated for an entity or organisation that:

- a. Has been established, constituted, or appointed pursuant to a treaty or agreement entered into by the Central Government with two or more nations, or a convention signed by the Central Government; (b) is established, constituted, or appointed not for profit; (c) is officially notified by the Central Government in the Official Gazette for the purposes of this clause.

### **96. Any amount received by an individual as a loan, either in lump sum or in instalments, in a transaction of reverse mortgage shall be exempt. [Sec. 10(43)]**

All income received by any individual for or on behalf of the New Pension System Trust shall be exempt from taxation.

### **98. Income of a body or an authority, Board, Trust, or Commission [Sec. 10(46)]**

Specified income refers to the income of a particular nature and extent as designated by the Central Government. The aforementioned individual's specified income shall be exempt if:

- a. It has been established by a Central, State, or Provincial Act, or constituted by the Central or State Government, with the purpose of regulating or administering activities for the public benefit..
- b. It is not involved in any commercial endeavors.
- c. The Central Government notifies it for the purpose of this clause.

### **99. Any income arising to a body or authority or Board or Trust or Commission [Sec. 10(46A)]**

Any income generated by a body, authority, board, trust, or commission, excluding companies, that has been established or constituted by a Central Act or State Act for one or more of the following purposes:

- i. addressing and fulfilling the demand for residential accommodation; (ii) the planning, development, or enhancement of urban and rural areas; (iii) overseeing, or overseeing and advancing, any activity for the public good; (iv) overseeing any issue, for the advantage of the public, related to the purpose for which it was established; and is announced by the Central Government in the Official Gazette for the purposes of this clause;

#### **100. Any income arising to NCGTCL [Sec. 10(46B)]**

Any income generated or derived by: (i) National Credit Guarantee Trustee Company Limited, a corporation created and entirely funded by the Central Government for the purpose of administering credit guarantee schemes; or (ii) A credit guarantee fund created and entirely financed by the Central Government, managed by the National Credit Guarantee Trustee Company Limited; (iii) The Credit Guarantee Fund Trust for Micro and Small Enterprises is a trust established by the Government of India and the Small Industries Development Bank of India, pursuant to section 3(1) of the Small Industries Development Bank of India Act, 1989.

#### **101. The income of an Infrastructure Debt Fund shall be exempt, provided it is established in accordance with the guidelines issued by the Central Government. [Sec. 10(47)]**

#### **102. Income received by a Foreign Company in Indian currency [Sec. 10(48)]**

Any income received in Indian currency by a foreign company from the sale of crude oil or other goods, or from rendering services as specified by the Central Government, to any individual in India shall be exempt, provided the following conditions are met:

- i. The foreign company's receipt of such income in India is in accordance with an agreement or arrangement sanctioned by the Central Government.
- ii. Considering the national interest, the agreement or arrangement is communicated by the Central Government.
- iii. The foreign entity is solely involved in the receipt of such income within India.

#### **103. Income of a foreign company from the storage of crude oil in India[Sec. 10(48A)]**

Income generated by a foreign company from the storage of crude oil in an Indian facility and subsequent sale to a resident in India shall be exempt, provided that such storage and sale are conducted in accordance with an agreement or arrangement sanctioned by the Central Government.

#### **104. Income of a foreign company from the sale of leftover stock of crude oil [Sec. 10(48B)]**

The income of a foreign corporation derived from the sale of residual crude oil stock from its facility in India, following the expiration or termination of the agreement, shall be exempt, contingent upon conditions specified by the Central Government.

#### **105. Income of Indian Strategic Petroleum Reserves Limited [Sec. 10(48C)]**

The exemption is contingent upon the condition that the crude oil is replenished in the storage facility within three years following the conclusion of the financial year in which the crude oil was initially extracted from the storage facility.

#### **106. Any income accruing or arising to an institution established for financing the infrastructure and development [Sec. 10(48D)]**

Any income generated by an institution established for financing infrastructure and development, created under an Act of Parliament and recognised by the Central

Government for this clause, shall be exempt for a duration of ten consecutive assessment years commencing from the assessment year pertinent to the previous year in which the institution is established.

#### **107. Any income accruing or arising to a developmental financing institution [Sec. 10(48E)]**

Any income generated by a development financing institution, licensed by the Reserve Bank of India under a parliamentary Act referenced in clause (48D) and notified by the Central Government for this purpose, shall be exempt for five consecutive assessment years commencing from the assessment year relevant to the previous year in which the institution is established. The Central Government may, through a notification under this clause, extend the exemption period for an additional duration not exceeding five consecutive assessment years, contingent upon the fulfillment of conditions specified in the notification.

#### **108. Income subject to equalisation levy [Sec. 10(50)]**

Any income generated from specified services or from e-commerce supplies or services rendered or facilitated on or after 01-04-2020, which is subject to equalization levy, is exempt from taxation.

#### **109. Income from newly established Units in Special Economic Zones (Sec. 10AA)**

An undertaking is defined as a Unit that meets the following criteria:

- i. It commences the manufacture or production of goods or the provision of services (including computer software) after March 31, 2006, but before April 1, 2021, within any Special Economic Zone.
- ii. It is not established through the division or reconfiguration of an existing enterprise. This condition shall not apply to any undertaking established as a result of the re-establishment, reconstruction, or revival by the assessee within the specified period of three years under section 33B.
- iii. It is not established through the transfer of machinery or equipment previously utilised for any purpose to a new business.
- iv. Section 10AA shall also be applicable to a unit if the proceeds from the sale of goods or the provision of services are received or brought into India by the assessee in convertible foreign exchange within six months from the conclusion of the previous year.

#### **Quantum Of Deduction:**

All profits and gains obtained from the export of such articles or services for the first five assessment years shall be exempt from taxation. Fifty percent of those profits and gains for an additional five assessment years. For the subsequent five consecutive assessment years, 50% of the profits and gains or the amount recorded in the Profit and Loss Account and credited to the 'Special Economic Zone Re-investment Allowance Reserve Account', whichever is lesser. No deduction shall be permitted to an assessee who fails to submit a return of income by the due date stipulated in section 139(1).

### 1.3.1.2 Incomes That Are Part of Total Income But are Exempt From Income Tax Obligations. (Sec. 86)

The profit share received by a member of an Association of Persons or Body of Individuals, as computed under section 67A, shall not be subject to taxation. If the Association of Persons or Body of Individuals is taxed at the maximum marginal rate or any higher rate, the member's share shall not be included in their total income. If the association or body has remitted tax at standard rates, income tax shall not be applicable to that share, although it will be included in the member's total income. This indicates that an income tax rebate will be permitted on such shares at the average tax rate. If the Association or body is not subject to income tax on its total income, a member's share shall be taxed as part of their total income, and the provisions of this section shall not apply.

### Recap

- ◊ Income that is not subject to income tax is exempted income.
- ◊ Income arising from the National Credit Guarantee Trustee Company Limited is fully exempted.
- ◊ The income of Khadi and Village Industries and the Board is fully exempted.

### Objective Questions

1. Which income is not subject to tax?
2. What is the percentage limit for exempting partial withdrawals from the National Pension System Trust?
3. What is the income exemption threshold for a minor child?
4. A domestic company whose shares are not publicly listed on a recognised exchange is referred to as what?
5. What is the maximum length of stay in India that qualifies a foreign national for compensation from a foreign entity under certain conditions?
6. Section deals with exemption of agricultural income?
7. Section 10 deals with .....

## Answers

1. Exempted income
2. Twenty Five
3. Actual sum or ₹ 1,500 for every minor child, whichever is less.
4. Venture Capital Undertaking
5. 90 days
6. Sec 10(1)
7. Exempted Income

## Assignments

1. Describe income exempted under Section 10
2. Identify incomes included in total incomes that are exempt from income tax liabilities.

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## Suggested Reading

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**2**  
**BLOCK**

## Residential status and Incidence of tax



SREENARAYANA GURU  
OPEN UNIVERSITY

# Residential Status

## Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ develop an understanding of the concept of residential status
- ◊ comprehend with different type of residents
- ◊ equip the learner with the residential status of Individual, HUF and Companies

## Prerequisites

The Income Tax Department must ascertain the residential status of a taxpayer, whether an individual or a company and it is pertinent during the tax filing period. This is indeed one of the factors determining an individual's tax liability. An individual's tax liability in India is contingent upon their residential status for a specific financial year. The term residential status is defined under Indian income tax laws and should not be conflated with an individual's citizenship in India. An individual may hold Indian citizenship yet be classified as a non-resident for a specific year. A foreign national may become a resident of India for income tax purposes in a specific year. The residential status of various entities, such as individuals, firms, and companies, is determined through distinct criteria.

## Keywords

Residential Status, Individual, Hindu Undivided Family, Companies

## Discussion

### 2.1.1 Residential Status

Income tax shall be levied on an individual's total income from the preceding year at the rate established for the assessment year by the Annual Finance Act. A person's total income is ascertained based on the stipulations of the Income Tax Act, while taxation is imposed in accordance with the Finance Act enacted by Parliament annually. Residential status determine your tax obligations and liabilities. It refers to an individual's or other tax status in a country.

### 2.1.2 Residence of Assessee

The extent of an assessee's total income is ascertained based on their residency in India during the preceding year (Sec. 5). The total income of each individual is contingent upon their residential status. The residential status of an assessee is ascertained based on their residence during the preceding year. The type of resident or assessee during the assessment year is irrelevant. Residence and citizenship are distinct concepts. The imposition of tax is unrelated to citizenship. An Indian individual may qualify as a non-resident, while a foreign national may be classified as a resident for income tax purposes. A person's residence may vary annually, but citizenship cannot be altered on a yearly basis.

### 2.1.3 Different Types of Residents

Assessee are classified into three categories based on their residence:

1. Persons who are ordinarily resident in India.
2. Persons who are not-ordinarily resident in India.
3. Persons who are non-resident.

Distinct regulations exist for ascertaining the residence of various categories of assessee. The various categories of assessee include individuals, Hindu Undivided Families, firms, Associations of Persons, body of individuals, companies, local authorities, and Artificial Juridical Persons. A person's residence need not remain constant. He may be ordinarily resident in one year, not ordinarily resident in another, and non-resident in a third year.

It is important to acknowledge that an individual may simultaneously reside in multiple countries. He may be a resident of India and other countries for the same preceding year.

#### 2.1.3.1 Individuals

An individual's residence is determined in accordance with the following rules:

## I. Resident (Ordinarily Resident) [Sec. 6(1)]

An individual is said to be resident in India in any previous year if he satisfies any one of the following basic conditions:

### A. Basic Conditions

- a. he has been in India in the previous year for a period of 182 days or more, or
- b. he has been in India for at least 365 days during the four years preceding the previous year and is in India for at least 60 days during the previous year.

### Exceptions to the above rules for a 60-day stay in India

- i. An individual who is a citizen of India and leaves India in any previous year for the purpose of employment or as a member of the crew of an Indian ship must have stayed in India for at least 182 days during the previous year instead of 60 days;
- ii. If any citizen of India or a foreign national of Indian origin, who is living outside India, comes on a visit to India in the previous year, he must have stayed in India for at least 120 days [if total income (other than income from foreign sources) exceeded 15 lakh during the previous year and if total income (other than income from foreign sources) upto 15 lakh during the previous year, he must have stayed in India for at least 182 days) during the previous year.

In other words, for an individual covered by the above two exceptions, only condition (a) must be met in order to become a resident of India, while condition (b) is irrelevant.

The term "Indian origin" refers to the fact that he, his parents, or any of his grandparents were born in undivided India. Furthermore, 'comes on a visit to India in the previous year' implies that he may travel to India for any reason, not to stay permanently. The purpose may be business or personal in nature, or he may come to meet his relatives or simply for a pleasure trip.

An individual who is a citizen of India and a member of the crew of a foreign-bound ship departing from India, the period or periods of stay in India shall be determined as may be prescribed.

#### a. Stay in India for 182 days or more

The first basic condition requires the individual to have spent at least 182 days in India in the previous year. It is not necessary for him to stay at a stretch for 182 days. His total stay of at least 182 days may include gaps. It is also not necessary to spend the entire stay in the same location. It could take place in various locations throughout India.

#### (b) Stay in India for at least 365 days during the four years preceding the previous year and for at least 60 days or 182 days, as the case may be, during the previous year

If an individual's total stay in India during the four years preceding the previous year is at least 365 days, or if he remains in India for at least 60 days or 182 days, as the case may be, during the previous year, he will be considered a resident for that year. Again,

it is not necessary that he spend the previous year in India for 60 days or 182 days, as the case may be, and the entire stay does not have to be in one location.

### **Deemed to be Resident [Sec. 6(1A)]**

An Indian citizen who is not required to pay tax in any other country or territory due to his domicile, residence, or other similar criteria is deemed to be resident in India. The condition for deemed residential status is only applicable if the total income (excluding income from foreign sources) exceeded 15 lakh in the previous year.

### **B. Additional Conditions [Sec. 6(6)(a)]**

In fact, in order to become ordinarily resident in India, an individual must satisfy both of the following conditions, in addition to satisfying any of the above-mentioned basic conditions:

- i. he has been resident in India in at least two out of the ten previous years preceding the relevant previous year, and
- ii. he has been in India for at least 730 days in all during the seven previous years preceding the relevant previous year.

In condition (i), residence for two years out of the ten years preceding the previous year indicates that the assessee met at least one of the basic conditions for two years out of the ten years preceding the previous year.

In condition (ii), the assessee must have physically been in India for at least 730 days in the seven years preceding the relevant previous year.

### **II. Not-ordinarily resident [Sec. 6(6)(a)]**

If an individual satisfies any one of the above basic conditions (a) or (b) but does not satisfy the aforesaid two additional conditions, he is said to be 'Not-ordinarily Resident'.

To be classified as not ordinarily resident, an individual must demonstrate that they have resided in India for less than two out of the ten years preceding the relevant previous year or have spent fewer than 730 days in India during the seven years prior to the relevant previous year.

An individual is classified as "Not ordinarily resident" in India for any preceding year if:

- i. he has been a non-resident in India in nine out of the ten previous years preceding that year, or
- ii. he has during the seven years preceding that year, been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days or less, or
- iii. An Indian citizen or a person of Indian descent with a total income, excluding foreign income, surpassing 15 lakh in the preceding year, who has resided in India for a cumulative duration of 120 days or more but less than 182 days, or
- iv. A citizen of India who is classified as deemed to be resident u/s 6(1A).

The assessee must demonstrate that he does not meet at least one of the additional requirements in order to be classified as a not-ordinarily resident, as the incidence of tax is lower in this situation than in the case of an ordinarily resident.

### **III. Non-resident**

If an individual does not meet any of the aforementioned fundamental conditions (a) and (b) outlined under 'Resident,' they are classified as Non-resident. In this instance, additional conditions are irrelevant.

#### **2.1.3.2 Hindu Undivided Family [Sec. 6(2)]**

##### **I. Resident (Ordinarily Resident)**

A Hindu Undivided Family is considered a resident in India for any previous year if the control and management of its affairs are located wholly or partially in India during that relevant previous year. A resident Hindu Undivided Family (H.U.F.) will be considered ordinarily resident only when its Karta fulfills both supplementary criteria for being ordinarily resident as an individual.

Control and management of affairs signifies de facto authority (Actual control/influence in practice) rather than merely a right to exercise control and management. The place of control and management is where the leader and their authority are located. The control and management do not need to be located at the site where the business or profession is conducted. The place of business can be different from the place of its control and management. The control and management of affairs must be situated wholly outside India in order to make them non-resident.

##### **II. Not-ordinarily resident**

A Hindu Undivided Family is 'not ordinarily resident' in India, if its Karta or manager (as an individual) is not ordinarily resident in India.

In this regard, it is important to note that where the managers or Kartas of H.U.F. differed from one another in the ten years preceding the previous year, the total period of stay of successive Kartas of the family should be aggregated to determine the Karta's residential status and, as a result, its H.U.F.

### **III. Non-resident**

HUF is 'non-resident' only when the control and management of their affairs is situated wholly outside India.

#### **2.1.3.3 Companies [Sec. 6(3)]**

##### **I. Resident (Ordinarily Resident)**

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

- i. It is an Indian company, or
- ii. Its place of effective management in that year is in India.

The term "place of effective management" (POEM) refers to a location where key

management and commercial decisions that are required for the overall operation of an entity's business are made.

## **II. Not-ordinarily resident**

A Company is never 'not-ordinarily resident'.

## **III. Non-resident**

If a company does not satisfy both the above conditions of residence, it is said to be a 'non-resident' company. It means that the company is not an Indian company, nor is its effective management based in India.

### **2.1.3.4 Residential status of AOP or Every other person**

Firm or AOP is always resident in India except when the control and management of affairs is wholly situated outside India. Firm and AOP will be non-resident if the entire control and management of affairs is situated outside India. Firm and AOP can never be not ordinarily resident.

#### **Illustrations 2.1.1**

Mr. Ramesh, an Indian citizen, left India for the first time on 10th August 2024 to start a new job in Singapore. He returned to India on 20th February 2025 for a short visit and stayed till the end of the financial year (31st March 2025). During his employment in Singapore, he earned a net salary of ₹60 lakhs, which was directly credited to his Singapore bank account.

Determine his residential status for the Previous Year 2024–25. Is he liable to pay tax in India on the income earned abroad?

#### **Answer**

Mr. Ramesh was in India from 20th February 2025 to 31st March 2025, which totals 40 days.

Since he stayed in India for less than 182 days in the Previous Year 2024–25, and he left India for employment, he does not satisfy any of the basic conditions under Section 6(1) of the Income-tax Act.

◊ Therefore, Mr. Ramesh is a Non-Resident for the Previous Year 2024–25.

Since he is a non-resident, only income received or accrued in India is taxable.

◊ His foreign salary (₹60 lakhs), earned and received in Singapore, is not taxable in India.

#### **Illustration 2.1.2**

Mr. Arjun, a person of Indian origin, has been residing in Australia since 2000. He visited India on 1st July 2023 and stayed till 15th February 2024. He again came to India on 10th March 2024 and remained till the end of the financial year. Determine his residential status for the previous year 2023–24 (Assessment Year 2024–25).



## Answer

Mr. Arjun was in India for:

- ◊ From 1st July 2023 to 15th February 2024 → 230 days
- ◊ From 10th March 2024 to 31st March 2024 → 22 days

Total stay = 252 days

Since Mr. Arjun is a person of Indian origin and his total stay in India during the previous year 2023–24 exceeds 182 days, he satisfies the basic condition under Section 6(1)(a).

Further, he does not satisfy both additional conditions:

- ◊ He was not a resident in 2 out of 10 preceding years, and
- ◊ His total stay in India during the last 7 years is less than 730 days

Therefore, Mr. Arjun is Resident but Not Ordinarily Resident (RNOR) for the previous year 2023–24.

## Illustration 2.1.3

Ms. Sneha, an Indian citizen working in Germany since 2010, came to India on 15th January 2024 and stayed till 31st March 2024. She was transferred to the Mumbai office of her company effective from 1st February 2024. Determine her residential status for the previous year 2023–24 (Assessment Year 2024–25).

## Answer

Ms. Sneha was in India from 15th January 2024 to 31st March 2024, which totals 76 days.

Since she came to India for employment (and not as a visitor), the 60-day condition (and not 182-day) applies.

- ◊ She stayed more than 60 days in the previous year (76 days )
- ◊ She also stayed in India for more than 365 days in the 4 years preceding previous year 2023–24

Hence, she satisfies the basic condition under Section 6(1).

Further, she satisfies both additional conditions:

1. She was a resident for at least 2 out of preceding 10 years
2. She was in India for more than 730 days during the preceding 7 years

Therefore, Ms. Sneha is a Resident and Ordinarily Resident (ROR) for the previous year 2023–24.

### Illustration 2.1.4

Mr. Rohit, an Indian citizen, has been working in Canada since 2012. He returned to India on 1st October 2023 to set up his own business in Mumbai and continued to stay in India thereafter. Determine his residential status for the previous year 2023–24 (Assessment Year 2024–25).

#### Answer

Mr. Rohit stayed in India from 1st October 2023 to 31st March 2024, i.e., 183 days.

- ◊ Since his stay exceeds 182 days, he satisfies the basic condition under Section 6(1)(a).

Now, check additional conditions:

1. He was a resident in 2 out of the 10 preceding previous years
2. His stay in the 7 preceding years exceeds 730 days

Therefore, Mr. Rohit is a Resident and Ordinarily Resident (ROR) for the previous year 2023–24.

### Illustration 2.1.5

Mr. Jay, a US citizen of Indian origin, has been visiting India for business meetings. He came to India for the following periods:

- ◊ 1st June 2023 to 30th September 2023
- ◊ 1st January 2024 to 28th February 2024

Determine his residential status for the previous year 2023–24 (Assessment Year 2024–25).

#### Answer

Stay during 2023–24:

- ◊ June to September 2023 → 122 days
- ◊ January to February 2024 → 59 days

Total = 181 days

Since Mr. Jay is a person of Indian origin, the 60-day rule applies. He stayed more than 60 days in India, and we must check whether he stayed 365 days in the preceding 4 years.

- ◊ Let's assume he visited India multiple times before, and his total stay exceeds 365 days during 2019–20 to 2022–23

So, he satisfies the basic condition.

But he does not satisfy both additional conditions (i.e., not a resident in 2 out of 10 years and not present in India for 730 days in past 7 years)

Therefore, Mr. Jay is Resident but Not Ordinarily Resident (RNOR) for the previous year 2023–24.

## Recap

- ◊ Total income of each person is based upon his residential status.
- ◊ Residence of a person may change from year to year.
- ◊ On the basis of residence, the assessees are divided into three categories.

## Objective Questions

1. On what basis assessees are classified?
2. How is persons total income determined?
3. What are different types of residents?
4. What is called location of the leader's position and governing authority?
5. What is meant by Indian Origin?
6. Into howmany categories are assessees divided on the basis of residential status
7. How is the total income of each person is determined?

## Answers

1. Residence
2. Based on stipulations of Income Tax Act.
3. Ordinarily resident, Not ordinarily resident, Non resident
4. Place of control and management
5. The individual, his parents or any of his grandparents was born in undivided India.
6. Three
7. Based on their residential status

## Assignments

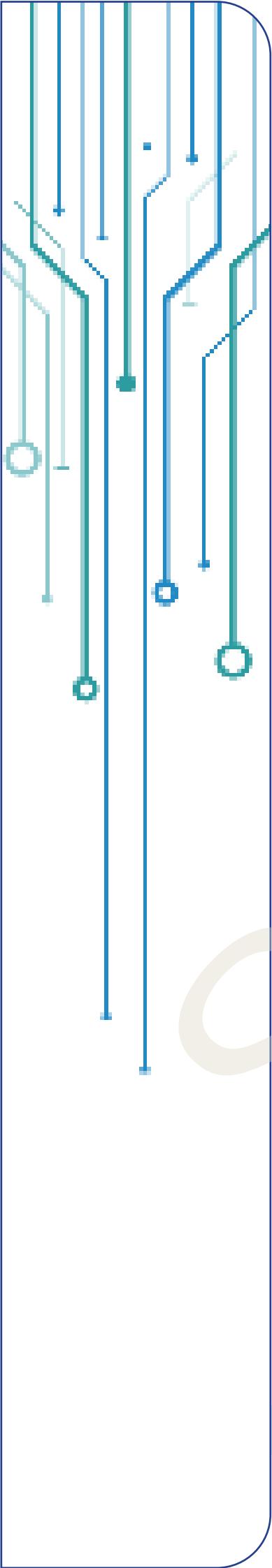
1. Essay on different types of residents.
2. Explain the residential status of individuals.
3. Explain the residential status of HUF and Companies.

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1. Goyal, H. M. D. S. (2024). *Income tax including tax planning & management A.Y 2024–25*. Sahitya Bhawan Publications.
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# Unit

## Incidence of Tax

### Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ develop an understanding of the concept of incidence of tax
- ◊ equip the learner with the scope of total income on the basis of incidence of tax

### Prerequisites

Tax incidence refers to the economic concept that analyses the distribution of a tax burden among various stakeholders, including buyers and sellers or producers and consumers. The tax incidence illustrates the allocation of tax responsibilities between the buyer and the seller. Tax incidence indicates the ultimate bearer of the tax burden, distinguishing it from the entity that directly remits the tax payment. The tax levied on a taxpayer is contingent upon their residential status, as well as the location and timing of income accrual or receipt.

### Keywords

Incidence of tax, accrual income, residential status

## Discussion

### 2.2.1 Scope Of Total Income on The Basis of Residence or Incidence of Tax

The amount of tax imposed on a taxpayer is determined by his residential status as well as the location and time of income accrual or receipt.

#### I. Incidence of tax in case of Resident (Ordinarily) [Sec. 5(1)]

A resident's total income for any previous year includes all income derived from whatever source, which:

- a. is received or deemed to be received in India in such year by or on behalf of such person, whether accrued or arisen anywhere; or
- b. accrues or arises or is deemed to accrue or arise to him in India during such year, whether received anywhere; or
- c. accrues or arises to him outside India during such year.

#### II. Incidence of tax in case of Not-ordinarily Resident

The total income of the previous year for an individual classified as 'Not-Ordinarily Resident' includes all income derived from any source.

- a. is received or deemed to be received in India in such year by or on behalf of such person, whether accrued or arisen anywhere; or
- b. accrues or arises or is deemed to accrue or arise to him in India during such year, whether received anywhere; or
- c. accrues or arises to him outside India from a business controlled in or a profession set-up in India.

#### III. Incidence of tax in the case of Non-resident

A non-resident person's total income for any given year includes all income from all sources, including:

- a. is received or deemed to be received in India in such year by or on behalf of such person, whether accrued or arisen anywhere; or
- b. accrues or arises or is deemed to accrue or arise to him in India during such year, whether received anywhere.

#### 'Received'

In the above mentioned regulations, the term 'received' denotes the initial occurrence of income receipt. The location of its initial receipt shall be the site where it is first received, rather than the location of subsequent remittances. Consequently, the foreign income of a non-resident is not subject to taxation, even if remitted to India, unless it is received or considered to be received within India.



### **'Deemed to be Received (Sec. 7 and 8)**

The phrase 'deemed to be received' in the aforementioned rules indicates that the income has not been physically received, yet it is considered received under the Income Tax Act. The instances are as follows:

- i. The annual accretion to the account of any employee participating in a Recognised Provident Fund is not actually received by the employee but is considered received during the previous year according to the law; (ii) the taxable portion of the transferred balance of an Unrecognised Provident Fund is regarded as received during the previous year; (iii) dividends are deemed received in the year they are declared, while interim dividends are considered income for the previous year in which they are unconditionally made available to the shareholder; (iv) tax deducted at source.

Moreover, if an individual has been employed by the Central Government on or after January 1, 2004, or by any other employer who contributed to the employee's pension scheme in the preceding year, such contribution shall be considered income received in that previous year.

### **'Accrue or Arise'**

Accrue or arise signifies the right to receive income as opposed to the actual receipt of income.

#### **2.2.1.1 Deemed to Accrue or Arise' (Sec. 9)**

The phrase 'deemed to accrue or arise' indicates that the income has not genuinely accrued or arisen in India, yet it is considered to accrue or arise in India according to the Income Tax Act. According to section 9(1), the following incomes are considered to accrue or arise in India:

- 1. Income is deemed to accrue or arise in India, if it accrues or arises, directly or indirectly: [Sec. 9(1)(i)]**
  - i. through or from any business connection in India; or
  - ii. through or from any property in India; or
  - iii. through or from any asset or source of income in India; or
  - iv. through the transfer of a capital asset situated in India.

For a business whose operations are not entirely carried out in India, the income considered to accrue or arise in India under this clause shall be limited to the portion of income that is reasonably attributable to the operations conducted within India.

- 2. Salary earned in India and received outside India: [Sec. 9(1)(ii)]**
  - a. The salary income for services performed in India shall be considered income generated in India.

- b. Any income categorized as 'Income from Salaries' that is payable during rest or leave periods, which are either preceded or succeeded by services performed in India and constitute a component of the employment contract, shall be considered income earned in India .
- 3. Salary payable by the Government to a citizen of India for services rendered outside India. [Sec. 9(1)(iii)]
- 4. Dividend paid by an Indian Company outside India. [Sec. 9(1)(iv)]
- 5. **Income by way of interest: Interest payable by the Indian Government is deemed to accrue or arise in India, whether it is paid on debts incurred or on moneys borrowed in India or outside India. [Sec. 9(1)(v)]**

Interest payable by an individual residing in India or by a non-resident concerning any debt incurred or funds borrowed and utilised for the purposes of a business or profession conducted by such individual in India is considered to accrue or arise in India. However, if it pertains to any funds borrowed or debts incurred for the operation of a business or profession conducted by that individual outside India, or for the purpose of generating income from any source outside India, it shall not be considered to accrue or arise in India.

- 6. **Income by way of royalty: Income from royalty shall be deemed to accrue or arise in India, if it is payable by the Indian Government. [Sec. 9(1)(vi)]**

Income from royalties payable by an individual residing in India or by a non-resident concerning any rights, property, information, or services utilised for a business or profession conducted by such individual in India, or for generating income from any source within India, is considered to accrue or arise in India. If it is payable for any rights, property, information, or services utilised in a business or profession conducted by such individual outside India, or for generating income from any source outside India, it shall not be considered to accrue or arise in India.

A substantial portion of royalty income, comprising lump-sum payments made by a resident for the transfer of all or any rights (including licensing) pertaining to Computer Software provided by a non-resident manufacturer, along with Computer or Computer-based equipment under any scheme sanctioned by the Government of India's Policy on Computer Software Export, Software Development and Training, 1986, shall not be considered to accrue or arise in India.

- 7. **Income by way of fees for technical services: Income from fees for technical services shall be deemed to accrue or arise in India if it is payable by the Indian Government. [Sec. 9(1)(vii)]**

Income derived from fees for technical services payable by an individual residing in India or a non-resident individual concerning services utilised in a business or profession conducted by such individual in India, or for the purpose of generating income from any source in India, shall be considered to accrue or arise in India. If it is payable for services utilised in a business or profession conducted by that individual outside India, or for the purpose of generating income from any source outside India, it shall not be considered to accrue or arise in India.



**8. Certain income being any sum of money paid or any property situate in India transferred on or after 5.7.2019 by a person resident in India to a person outside India shall be deemed to accrue or arise in India. Or on or after 1.4.2023 by a person resident in India to a person not ordinarily resident in India shall be deemed to accrue or arise in India. [Sec. 9(1)(viii)]**

Property received by an individual outside India from a relative residing in India or on the occasion of their marriage shall be exempt under Section 56.

The revenue from the following shall not be considered to accrue or arise in India for non-residents:

Acquisition of goods in India for export purposes.

Compilation of news and opinions in India for dissemination outside the country for the operation of a news agency or the publication of magazines, among other activities.

Filming of a motion picture in India.

Income considered to accrue or arise in India under points (5), (6), and (7) shall be incorporated into the total income of the non-resident, irrespective of (i) the non-resident's residence, place of business, or business connection in India; or (ii) the non-resident's provision of services in India.

**Exceptions:**

1. A non-resident shall not be considered to have accrued or derived income in India from activities limited to the purchase of goods in India for export purposes.
2. For a non-resident operating a news agency or publishing newspapers, magazines, or journals, no income shall be considered to accrue or arise in India from activities limited to the collection of news and opinions within India for transmission outside of India.
3. The income of a non-resident individual, firm, or company (where neither the individual nor any partners of the firm or shareholders of the company are Indian citizens) shall not be considered to accrue or arise in India from operations limited to the filming of any cinematographic work in India.
  - 3A. A foreign company involved in diamond mining shall not be considered to generate income in India from activities limited to the exhibition of uncut and unassorted diamonds in any designated zone specified by the Central Government.
4. (4) Pension for judges of the Federal Court or High Court appointed prior to 15.8.1947, who continued to serve as judges in India after the Constitution's commencement, shall not be considered to accrue or arise in India if:
  - i. it is paid/payable outside India;
  - ii. such person resides permanently outside India.

## 2.2.2 Business Connection

A business connection encompasses any commercial activity conducted by an individual acting on behalf of a non-resident, provided that:

- i. the individual possesses and routinely exercises the authority to finalise contracts on behalf of the non-resident in India, unless their activities are confined to procuring goods or merchandise for the non-resident; or
- ii. the individual lacks such authority but consistently maintains a stock of goods or merchandise in India from which they regularly distribute goods or merchandise on behalf of the non-resident;
- iii. consistently obtains orders in India, primarily or entirely for the non-resident or for that non-resident along with other non-residents who are controlled by, controlling, or under the same common control as that non-resident.

The term "business connection" shall not be deemed to exist when a non-resident conducts business through a broker, general commission agent, or any other independent agent acting in the normal course of their business.

If a broker, general commission agent, or any other agent primarily or exclusively represents a non-resident (principal non-resident) or acts on behalf of that non-resident and other non-residents who are controlled by the principal non-resident, possess a controlling interest in the principal non-resident, or are under the same common control as the principal non-resident, such an individual shall not be considered a broker, general commission agent, or an agent of independent status. If a business operates in India through a person specified in (i), (ii), or (iii), only the income attributable to activities conducted in India shall be considered to accrue or arise in India.

## 2.2.3 Tax Incidence in Brief

Table 2.2.2 Tax incidence

	Income	Ordinarily resident	Non ordinarily resident	Non Resident
1.	Income received in India whether accrued or arisen in India or outside India	Yes	Yes	Yes
2.	Income deemed to be received in India whether accrued or arisen 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 or arisen outside India from a business controlled from India or a profession set up in India	Yes	Yes	No
6.	Income received and accrued or arisen outside India from a business controlled from outside India or a profession set up outside India	Yes	No	No
7.	Income received and accrued or arisen outside India from any other sources	Yes	No	No
8.	Income accrued or arisen and received outside India in earlier years but later on remitted to India during the previous year	No	No	No
9.	Past untaxed foreign income brought in India in the previous year	No	No	No

### Illustration 2.3.1

The following are the incomes of Mr X. Compute the gross total income of Mr X if he is Ordinarily resident, Not ordinarily resident and Nonresident.

1. Profit earned from business in Kanpur Rs 4,000.
2. Income from house property in Iran received in India Rs 2,000.
3. Profit from business in Iran received in India Rs 7,000.
4. Income from profession as a management consultant in Thailand received there. The profession set up in India Rs 9,000.
5. Pension from former employer in India, but received in Japan Rs 3,000.

### Solution

Computation of Gross Total Income of Mr X.

	Ordinarily resident	Not ordinarily resident	Non resident
Profit earned from business in Kanpur	4,000	4,000	4,000
Income from house property in Iran received in India	2,000	2,000	2,000
Profit from business in Iran received in India	7,000	7,000	7,000
Income from profession in Thailand(Profession set up in India)	9,000	9,000	---
Pension from former employer in India, but received in Japan	3,000	3,000	3,000
Gross Total Income	25,000	25,000	16,000

### Illustration 2.3.2

Mr Y has furnished the following particulars. Compute his gross total income if he is a non resident.

1. Salary received in India (Computed) Rs 5000
2. Income from House Property in India (Computed) Rs 4,000
3. Interest on savings bank deposits in State Bank of India Rs 2,000
4. Income from business in Pakistan being controlled from India Rs 7,000

### Solution

Computation of Gross Total Income of Mr Y

Salary received in India (Computed)	5,000
Income from House Property in India (Computed)	4,000
Interest on savings bank deposits in State Bank of India	2,000
Gross Total Income	11,000

Note: Income from business in Pakistan being controlled from India is not taxable in the case of a non resident.

### Illustration 2.3.3

Compute the gross total income of Mr Z if he is an Ordinarily resident, Not ordinarily resident or Non-resident.

1. Profit of a hotel business in China Rs 15,000
2. Royalty received in Singapore from a resident of India for technical services provided for a business carried on in Singapore Rs 10,000.
3. Interest on Bonds issued by Government of Japan received and spent there Rs 12,000
4. Income from house property situated in Nepal, received there Rs 17,000.
5. Profit from business in Bhutan, deposited in a bank there, Rs 10,000
6. Profit on sale of a building in India but received in Bhutan, Rs 13,000.

### Solution

Computation of Gross Total Income of Mr Z

	Ordinarily resident	Not ordinarily resident	Non resident
Profit of a hotel business at China	15,000	--	--
Royalty received in Singapore from a resident of India for technical services provided for a business carried on in Singapore	10,000	--	--
Interest on Bonds issued by Government of Japan received and spent there	12,000	--	--
Income from house property situated in Nepal, received there	17,000	--	--
Profit from business in Bhutan	10,000	--	--
Profit on sale of a building in India	13,000	13,000	13,000
Gross Total Income	77,000	13,000	13,000

### Illustration 2.3.4

Compute the gross total income of Mr H if he is Ordinarily resident, Not ordinarily resident or Non resident.

1. Foreign Income Rs 50,000.
2. Profit from a business in Delhi managed from India Rs 28,000.
3. Dividend received in London from a company registered in India but mainly operating in the UK Rs 12,000.

4. Pension from former employer in Italy, but received in India directly, Rs 15,000.
5. Income from profession set up in India, half of which received in Germany Rs 25,000.

### Solution

Computation of Gross Total Income of Mr H

	Ordinarily resident	Not ordinarily resident	Non resident
Foreign Income	50,000	--	--
Profit from a business in Delhi managed from India	28,000	28,000	28,000
Dividend from an Indian Company	12,000	12,000	12,000
Pension from former employer in Italy but received in India directly	15,000	15,000	15,000
Income from profession set up in India, half of which received in Germany	25,000	25,000	25,000
Gross Total Income	1,30,000	80,000	80,000

### Illustration 2.3.5

Compute the gross total income of Mr S if he is an Ordinarily resident, Not ordinarily resident or Non-resident.

1. Income earned and received in Bhutan from bank deposits there Rs 5,000.
2. Income accrued in Kochi but received in Srilanka Rs 3,000.
3. Income from profession in Spain received there. The profession was set up in India Rs 12,000.
4. Income from agriculture in Canada, received there, but later on remitted to India Rs 62,000
5. Income from assets in Singapore, received in India Rs 13,000.

## Solution

Computation of Gross Total Income of Mr S

	Ordinarily resident	Not ordinarily resident	Non resident
Income from bank deposits in Bhutan	5,000		
Income accrued in India	3,000	3,000	3,000
Profession set up in India	12,000	12,000	--
Income from agricultural in Canada, received outside India	62,000	--	--
Income received in India	13,000	13,000	13,000
Gross Total Income	95,000	28,000	16,000

## Recap

- ◊ Incidence of tax depends on residential status.
- ◊ Place and time of accrual of income is the basis of incidence of tax.
- ◊ Incidence of tax is applicable to Ordinarily Resident, Not ordinarily Resident and Non Resident.

## Objective Questions

1. What is meant by the right to receive as against the receipt of income?
2. What does it mean when income is considered to have accrued in India even though it hasn't?
3. What does it mean to receive income for the first time?
4. What is the basis of the incidence of tax?
5. Incidence of tax is applicable to which categories of assessors.
6. What are the basis of incidence of tax?
7. Incidence of tax depends upon .....

## Answers

1. Accrue or arise
2. Deemed to accrue or arise
3. Received
4. Residential status and place and time of accrual of income
5. Ordinarily resident, not ordinarily resident and non resident
6. Place and time of accrual of income
7. Residential status

## Assignments

1. Point out incidence of tax based on residential status.
2. Explain the concept of accrue and deemed to accrue.
3. Briefly explain the concept of Business Connection.

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1. Goyal, H. M. D. S. (2024). *Income Tax including Tax Planning & Management A.Y 2024-25*. Sahitya Bhawan Publications.
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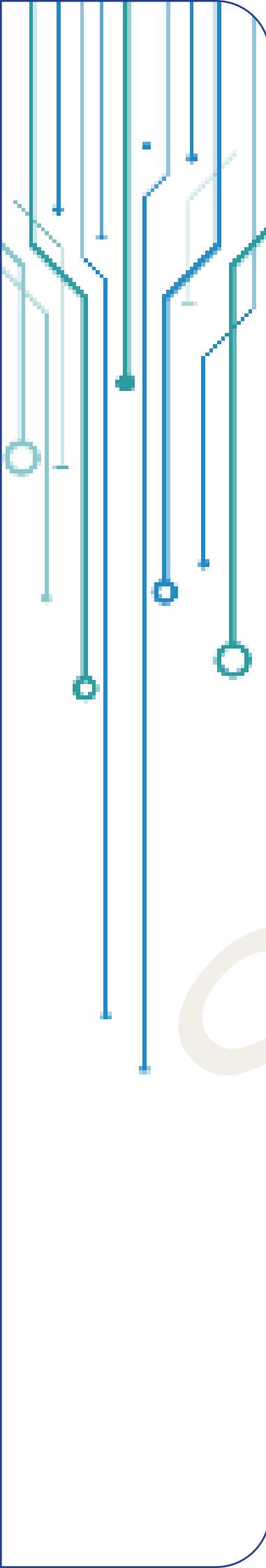
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3  
BLOCK

Income from Salary



# Unit 1

## Introduction

### Learning Outcomes

After completing this unit, the learner will be able to;

- ◊ understand the meaning of salary income
- ◊ understand the key points regarding income from salary
- ◊ understand the basis of the charge of income from salary

### Prerequisites

So far, we have covered the basics of Income tax, with a brief introduction to the evolution of income tax and definitions of basic terms relating to income tax presented in Block 1. As we have already learned, income tax is a direct tax imposed upon persons, including individuals, bodies of individuals, associations of persons, companies, HUFs, etc. Also, we have looked into how the residential status of a person is determined and its role in the computation of tax. For the purpose of computing tax, it is important to calculate the total income of a person, and this total income is divided into five different heads, starting with “income from salary”. In this block, we will be discussing the provisions regarding the calculation of income from the salary of an individual. We will start with Unit 1, which will introduce you to the concept of salary and the key points you have to understand with regard to the computation of salary income. This will give you a head start on the computation of income from salary, which we will be dealing with in the subsequent units.

## Keywords

Salary, income from salary, wages, basis of charge, chargeability.

## Discussion

Income tax is charged on the total income of an assessee. Total income is calculated after deducting allowed deductions from the Gross Total Income. Gross Total Income includes income under five heads. These five heads are :

1. Income from Salaries ( Sec 15 to 17)
2. Income From House Property ( Sec 22 to 27 )
3. Profits and Gains of Business or Profession ( Sec 28 to 44 )
4. Capital Gains ( Sec 45 to 55 )
5. Income From Other sources ( Sec 56 to 59 )

Each head of income is to be computed separately as per the provisions of the Income Tax Act. Then income under each head is to be added together after adjusting past and present losses. This will provide gross total income. From the gross total income, we can deduct permissible deductions, the figure is the total income. The tax liability of the assessee is calculated as per the prescribed rates of income tax on total income.

### 3.1.1 Income from Salary

Salary income of an employee is to be computed in accordance with the provisions laid down in sections 15, 16 and 17. Section 15 gives the scope of this head and tells us which incomes shall form part of this head. Section 16 gives deductions to be allowed out of incomes taxable under this head. Section 17(1) defines the word 'salary' as mentioned in section 15. Section 17(2) and 17(3) further define the terms 'Perquisites' and 'Profit in lieu of salary'.

Any compensation provided by an employer to an employee in exchange for services rendered is termed as salary, as per Section 17(1). It encompasses wages and the monetary value of taxable benefits and facilities provided by the employer. The following are the characteristics of salary income:

1. Salary received as an advance or in arrears is subject to taxation if received in the preceding year.
2. Salary income constitutes the primary category of income and is taxable under sections 15 to 17 of the Income Tax Act.
3. Salary may be taxed on an accrual basis or on a cash basis, whichever occurs first.



4. Salary is considered due when the employee acquires the entitlement to receive it.
5. Salary is classified as being on a receipt basis when any payment or allowance made to an employee in the preceding year is not yet due or has not become due.
6. Salary that has been taxed on an accrual basis cannot be taxed again on a cash basis.
7. Salary may be payable either on the final day of the month or on the first day of the subsequent month.
8. Salary includes:
  - a. Wages
  - b. Gratuity
  - c. Annuity or Pension
  - d. Advance Salary
  - e. Encashment of earned leave
  - f. Any fees, commission, perquisites or profit in lieu of salary.
  - g. Annual accretion to Recognised Provident Fund
  - h. Taxable portion of the transferred balance
  - i. Contribution made by the Central Government to the Agniveer Corpus Fund account of an individual u/s 80CCH.

### 3.1.1.1 Key points regarding Income from Salary

**1. Salaries:** Salary is the remuneration received by or accruing periodically to an individual for service rendered as a result of an expressed or implied contract. Under Section 15, the following incomes shall be chargeable to income tax under the head “Salaries”.

- a. Any salary due from the former employer or present employer in the previous year, whether paid or not .
- b. Any salary paid or allowed in the previous year, by or on behalf of a former employer or present employer , though not due or before it become due.
- c. Any arrears of salary paid in the previous year by or on behalf of a former employer or present employer, if not charged to tax in the period to which it relates.

Thus as per the provisions of this section, the amount of salary due in this year, amount of advance salary received and the amount of arrears of salary received during the previous year from the present employer or previous employer are to be included in this head. For the purposes of the Income Tax Act, there is no distinction between the wages of labourers and salaries of high officials.

**2. Foreign salary and pension:** Salary and pension received from foreign governments is taxable under the head ‘Income from Salaries’.

**3. Employer-employee relationship:** A relationship of employer and employee is required for the amount received to be classified under the category of salary. All servants are employees, whereas an agent may or may not qualify as an employee. If an employee performs any work for their employer that is unrelated to their service, the compensation for such work will not be classified as salary. For example, Surya Films had employed Krishna as an actor, for which he is getting paid a monthly remuneration of Rs. 2 lakhs. He acts in various films produced by various producers. The remuneration for acting in such films is directly paid to Surya Films. Here, Rs. 2 lakhs constitute salary in the hands of Krishna, as there exists an employer-employee relationship between Surya Films and Krishna.

As per the principle stated above, the following payments can not be treated as salary:

- a. *Agent and Principal*** : If a person is acting as an agent for his principal, any commission or remuneration earned by the agent is not taxable under the head “salaries”. This is because an agent is not the employee of his principal.
- b. *Salary received by a partner*** from their firm shall not be taxable as salary, because there is no employer-employee relationship between the firm and the partner. Such salary shall be taxable under the head " Profits & Gains of business or profession".
- c. *Salary received by the proprietor from his proprietorship firm*** is not an income. As proprietor and proprietorship firm are the same person, and no one can earn from himself.
- d. *Remuneration to director from*** his company can be treated as salary only if the director is the employee of the company, otherwise the same shall be taxable under the head “ Income from other sources”.

**4. Salaries and professional income:** Where the employment is merely incidental to the exercise of a profession, the income from such employment would be professional income, taxable under section 28.

**5. Receipts from a person other than the employer:** Perquisites or profits or any remuneration received from a person other than the employer would be taxable under the head 'Income from Other Sources' even if they accrue to the employee by reason of his employment.

**6. Payment made after cessation of employment:** Payment made by an employer to his employee after the cessation of his employment is also taxable under the head 'Income from Salaries'. It is taxable under this head because it represents remuneration for services rendered in the past.

**7. Payments made to employee or to the widow or legal heirs:** a) Lump-sum payment made gratuitously or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while still in active service, will not be taxable as income. b) Where a person or his heir receives ex gratia payment from the Central Government or State Government or Local Authority or Public Sector Undertaking, consequent upon injury to the person or death of family member, while on duty is not liable to income tax.

**8. Full or part-time employment:** Once the relationship between employer and employee exists, the income is to be charged under the head “salaries”. It does not matter whether the employee is a full-time employee or a part-time one.

**9. Forgoing of salary:** Once salary accrues, the subsequent waiver by the employee does not absolve him from liability to income tax. Such a waiver is only an application and hence, chargeable to tax. For example, Mr. X instructs his employer that he is not interested in receiving salary for the month of April 2025, and the same might be donated to a charitable trust. Here, Mr. X cannot claim that he should not be taxed in respect of salary for April 2025 because the donation was made only because of his instruction. It is only an application of income.

**10. Surrender of salary:** If an employee surrenders his salary, in the public interest, to the Central Government under section 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered would be exempt while computing his taxable income.

**11. Pension:** The pension received by an employee post-retirement is subject to taxation as salary.

**12. Remuneration of a partner:** Any remuneration received by a partner from the firm in which he is a partner is subject to taxation under the category of Profits and Gains of Business or Profession.

**13. Family pension:** Any family pension received by the widow or legal heirs of a deceased employee is subject to taxation under the Income from Other Sources category.

**14. Tax free salary:** When a salary is disbursed tax-free, the employee must incorporate in their total income the sum of the net salary received and the tax remitted on their behalf by the employer, except as stipulated under Sec 10(10CC).

**15. Place of accrual of salary:** Under section 9(1)(ii), salary earned in India is deemed to accrue or arise in India even if it is paid outside India or it is paid or payable after the contract employment in India comes to an end.

**16. Salary of MP:** The salary of a Member of Parliament is subject to taxation under the category of Income from Other Sources.

**17. Payment during termination:** Payments made by an employer to an employee following the termination of employment are subject to taxation under the category of Salaries.

### 3.1.2 Basis of charge (Section 15)

#### 3.1.2.1 Conditions of chargeability

Section 15 deals with the basis of charge under the head “Salaries”. Salary is chargeable to tax either on ‘due basis’ or on ‘receipt’ basis, whichever is earlier. However, where any salary, paid in advance, is assessed in the year of payment, it

cannot be subsequently brought to tax in the year in which it becomes due. If the salary in arrears has already been assessed on due basis, the same cannot be taxed again when it is paid.

**Example:** If A draws his salary in advance for the month of April 2025 in the month of March 2025 itself, the same becomes chargeable on receipt basis and is to be assessed as income of the P.Y. 2024-25 i.e., AY 2025-26. However, the salary for the AY 2026-27 will not include that of April 2025.

### **Components of Salary**

1. Basic Salary or Wages
2. Advance Pay
3. Arrear of Salary
4. Dearness Pay/ Dearness allowances
5. Annuity
6. Pension

#### ***Advance salary***

Advance salary is taxable when it is received by the employee irrespective of the fact whether it is due or not. The rule behind this is the basis of taxability of salary i.e., salary on due or receipt basis, whichever is earlier.

It may so happen that when advance salary is included and charged in a particular previous year, the rate of tax at which the employee is assessed may be higher than the normal rate of tax to which have been assessed. Section 89 provides relief in these types of cases.

#### ***Difference between advance salary and advance against salary***

Loan is different from salary. When an employee takes a loan from his employer, which is repayable in certain specified installments, the loan amount cannot be brought to tax as salary of the employee. Similarly, advance against salary is different from advance salary. It is an advance taken by the employee from his employer. This advance is generally adjusted with his salary over a specified time period. It cannot be taxed as salary.

#### ***Arrears of salary***

Normally speaking, salary arrears must be charged on due basis. However, there are circumstances when it may not be possible to bring the same to charge on due basis.

**Example:** If the Pay Commission is appointed by the central government and it recommends revision of salaries of employees with retrospective date, the arrears received in that connection will be charged on receipt basis. Here also, relief under section 89 is available.

## Due Dates of Salary

1. Government Employees : In the case of employees of the Government and Semi Govt. , salary for the particular month is due on 1<sup>st</sup> of the next month. So in this case salary from March to February of the current financial year is taken into account for assessing tax.
2. Employee of non Govt bodies and banks : salary for a particular month is due on the last date of the same month. In such a case salary from April of the current financial year upto the month of March of the current year is taken into account for assessing tax.

## Recap

- ◊ Salary is the compensation provided by an employer to an employee for the services rendered by the employee.
- ◊ Salary constitutes the primary category of income and is taxable u/s 15 to 17 of IT Act.
- ◊ Foreign salary and pension are taxable under the head salaries.
- ◊ Compensation received on the basis of full time and part time employment is considered as salary.
- ◊ Remuneration of a partner is not salary, it come under profits and gain from business or profession.
- ◊ Family pension received by the widow or legal heirs of a deceased employee is not taxed under salary.
- ◊ Advance salary is taxable when it is received by the employee irrespective of the fact whether it is due or not.
- ◊ Arrears of salary must be charged on due basis, but there may be situations where it is not possible to bring the same to charge on due basis.

## Objective Questions

1. Which section defines the term salary?
2. Which are the section that deals with the computation of salary income?
3. Salary received as an advance or arrears is subject to taxation if received in the preceding year. True or false.
4. Contribution made by the Central Government to the Agniveer Corpus Fund account of an individual u/s 80CCH does not form part of salary. True or false.
5. To consider a payment as salary, what kind of a relationship is mandatory between payer and payee?

## Answers

1. Section 17
2. Section 15 to section 17
3. True
4. False
5. Employer employee relationship

## Assignments

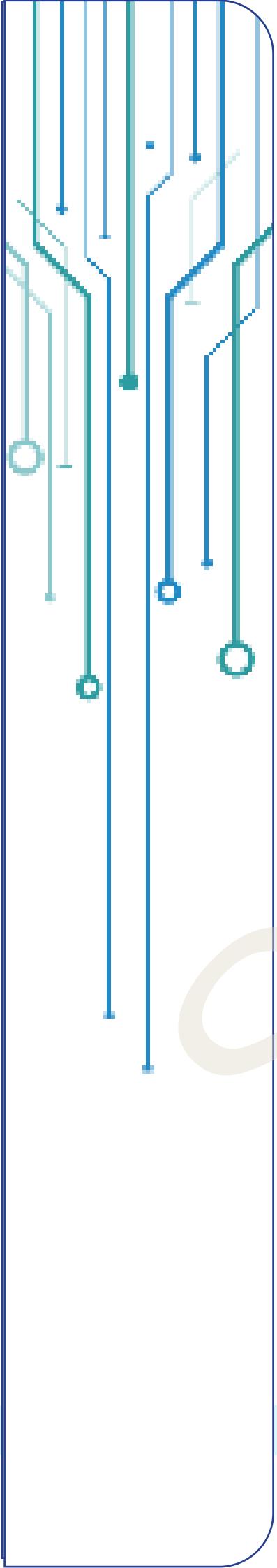
1. Explain the concept of salary with real-life examples.
2. All servants are employees, but an agent may or may not qualify as an employee. Justify, with examples.
3. List out the agent principal or master servant relationships where employer-employee relationships exist. Provide justifications.
4. Explain basis of charge u/s 15
5. Define salary.
6. What are the components of salary?
7. Explain the characteristics of salary.
8. Write a note on employer employee relationship?.
9. Describe the treatment of receipts from a person other than the employer.
10. Describe the payment made after cessation of employment.

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# Unit Allowances and deductions

## Learning Outcomes

After completing this unit, the learner will be able to;

- ◊ understand the meaning of allowances and perquisites
- ◊ identify taxable, tax free and partly taxable allowances and perquisites
- ◊ identify the deductions and exemptions provided under the head salaries

## Prerequisites

In the previous Unit we have introduced the concept of salary, the components and the basis of chargeability. By now you must have understood that salary includes any compensation paid by an employer to an employee for the services rendered, and you are aware of the importance of employer employee relationship in the case of salary. Only those compensations arising out of an employer employee relationship will be considered as salary. In this unit we will be dealing with various allowances and deductions with regard to salary. It is important to have an understanding about the allowances and deductions, because it is significant in the computation of salary income. In an employer employee relationship an employer will provide various allowances. For such allowances received from the employer, the employee will be able to avail exemptions from tax. Similarly, other benefits may also be provided by the employer, which are known as perquisites. Such perquisites also possess tax implications, and the employee can reduce his tax burden by claiming the exemptions with regard to these allowances and perquisites. In addition, there are some statutory deductions provided in the Act, to reduce the tax burden of the individual. It is important to know about these allowances and deductions, because only

the salary that is adjusted against all such exemptions and deductions will be subject to tax. Hence, before moving on to computation of salary, you must have a thorough understanding of allowances and deduction from salary.

## Keywords

Allowances, perquisites, House rental allowance, deductions, exemptions.

## Discussion

### 3.2.1 Allowances

Cash payments made by the employer to employees on a monthly basis, apart from salary, are referred to as allowances. It is defined as a fixed amount of money paid by the employer to his employees in addition to the salary. Under the Income-tax Act, 1961, allowance is taxable on due or receipt basis, whichever is earlier. These allowances are generally taxable unless some specific exemption has been provided in respect of such allowance. From the perspective of income tax, there are three types of allowances:

- ◊ Taxable Allowances
- ◊ Fully Exempted Allowances
- ◊ Allowances exempt up to Specified Limit

#### 3.2.1.1 Taxable Allowances

The taxable allowance that are include while computing the taxable income from salary include:

1. Entertainment allowance
2. Dearness Allowance and Dearness Pay disbursed to employees to offset the increase in price levels. When dearness allowance is provided according to employment terms, it is incorporated into salary to calculate the exemption thresholds of
  - a. House rent allowance,
  - b. Recognized provident fund,
  - c. Gratuity
  - d. Assessing the value of a rent-free residence
  - e. Retirement benefits considerations.

When the entire or a portion of the dearness allowance is transformed into dearness

pay, it integrates into the basic salary.

3. Tiffin Allowance for lunch and refreshments to the employees
4. Servant Allowance
5. City Compensatory Allowance
6. Deputation Allowance is provided to an employee assigned from their permanent place of service to another institution on a temporary basis.
7. Overtime Allowance
8. Warden and Proctor Allowances are provided in educational institutions for serving in the capacities of warden or proctor.
9. Family Allowance to armed personnel while on the field without family
10. Project Allowance
11. Marriage Allowance
12. Rural Allowance
13. Telephone Allowance
14. Education Allowance
15. Dinner Allowance
16. Health Allowance
17. Holiday Allowance
18. Special Qualification Allowance
19. Hill Allowance is given to employees working in hilly areas if the place is located at less than 1000 meters height from sea level.
20. Non-practicing Allowance given to medical doctors who are in government service and are banned from doing private practice.

### **3.2.1.2 Fully Exempted Allowance**

Fully exempted allowances include:

1. Foreign allowances paid by the Government to employees posted abroad.
2. Allowance to supreme court/ high court judges
3. Allowance paid by United Nation Organisation to its employees
4. Sumptuary Allowances given to judges of High Court and Supreme Court.
5. Per-diem Allowance paid for the purposes of use of hotel, boarding and lodging facilities to an employee.

### **3.2.1.3 Partly exempted allowances**

The allowances that are partly exempted from the computation of income from salary include:

1. Travelling Allowance.



2. Daily allowance
3. Conveyance allowance
4. House rent allowance [Section 10(13A)], which is a special allowance specifically granted to an employee by his employer toward payment of rent for residence of the employee.
5. Special allowance granted to meet expenses incurred wholly, necessarily and exclusively in the performance of the duties of an office or employment [Section 10 (14)(ii)]. This includes:
  - a. Helper allowance
  - b. Research allowance
  - c. Uniform allowance
6. Special allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he ordinarily resides or to compensate him for the increased cost of living [Section 10 (14)(ii)]. This include:
  - a. Special compensatory (Hilly areas) allowance
  - b. Border area allowance or remote locality allowance or difficult area allowance or disturbed area allowance.
  - c. Special compensatory (tribal areas/ schedule areas/ agency areas) allowance [specified states].
  - d. Allowance to employees working in the transport system.
  - e. Children education allowance
  - f. Allowance to meet hostel expenditure of children.
  - g. Compensatory field area allowance [Specified areas in specified states]
  - h. Compensatory modified field area allowance [specified areas in specified states]
  - i. Counter insurgency allowance.
  - j. Underground allowance.
  - k. High altitude allowance.
  - l. Special compensatory highly active field area allowance.
  - m. Island (duty) allowance granted to armed forces in Andaman & Nicobar and Lakshadweep Group of Islands.

### 3.2.2 Perquisites

A perquisite refers to an extra benefit in addition to salary or wages legally due by way of a contract or services rendered. Perks or perquisites may be defined as any casual emoluments, fee, and profit attached to an office or position in addition to salary or wages.

1. It may be in cash, or in kind.

2. Reimbursement of expenses incurred in the official discharge of duties is not a perquisite.
3. Perquisites may arise in the course of employment or in the course of profession. If it arises from a relationship of employer-employee, then the value of the perquisite is taxable as salary. However, if it arises during the course of profession, the value of such perquisite is chargeable as profits and gains of business or profession
4. Perquisite will become taxable only if it has a legal origin. An unauthorised advantage taken by an employee without his employer's sanction cannot be considered as a perquisite under the Act.

Perquisites may be classified into:

1. Perquisites taxable in the case of all employees.
2. Tax free perquisites in case of all employees.
3. Perquisites taxable only in the hands of specified employees.

### **3.2.2.1 Perquisites taxable in the case of all employees**

Perquisites that are taxable in the case of all employees include:

1. Rent free accommodation, which is the value of rent-free accommodation provided to the assessee by his employer computed in prescribed manner [Section 17 (2)(i)]
2. Concession in rent, which is the value of any accommodation provided to the assessee by his employer at a concessional rate. [Section 17 (2) (ii)]
3. Payment by the employer in respect of an obligation of the employee.
4. Amount payable by an employer directly or indirectly to effect an assurance on the life of the assessee.
5. Specified security or sweat equity shares allotted or transferred, by the employer.
6. Amount or the aggregate of amounts of any contribution made to the account of the assessee by employer:
  - a. In a recognised provident fund
  - b. In National Pension System (NPS)
  - c. In an approved superannuation fund.
7. Annual accretion to the balance at the credit of the recognised provident fund/ NPS/approved superannuation fund which relates to the employer's contribution and included in total income (on account of the same having exceeded Rs/ 750000)
8. Any other fringe benefit or amenity.

### **3.2.2.2 Tax free Perquisites in case of all employees**

Tax-free benefits are not subject to valuation. The value of the following perquisites shall be excluded from an employee's salary income:

1. Telephone provided by an employer to an employee at his residence.
2. Transport facility provided by an employer, being airline or the railways for the purpose of transport of passenger or goods to his employees of an either free of charge or at concessional rate
3. Perquisites allowed outside India by the government to a citizen of India for rendering services outside India.
4. Contribution of employer to the staff group insurance scheme.
5. Annual premium paid by the employer on personal accident policy effected by him on the life of his employee.
6. Refreshment provided to all employees during working hours in office premises.
7. Subsidise lunch provided to employees at workplace during working hours, at the office or business premises, provided that the value of the meal is below Rs.50.
8. Recreational facilities such as club facilities provided to employees in general.
9. Expenses incurred by the employer on training of employees or amount paid for refresher management courses including expenses on boarding and lodging.
10. Sum payable by an employer to:
  - a. RPF (Recongnised Prouident Fund
  - b. Approved superannuation fund
  - c. Deposit linked insurance fund established under the Coal Mines Provident Fund and Miscellaneous provisions Act, 1948 or Employees' Provident Fund and Miscellaneous Provision Act, 1952
11. Leave travel concession.
12. Medical benefits subject to prescribed limits.
13. Rent free official residence of provided to the Judge of a High Court or a Supreme Court.
14. Conveyance facility provided to High Court Judges under section 22B of the High Court Judges (Conditions of Service) Act, 1954, and Supreme Court Judges u/s 23A of Supreme Court Judges (Conditions of Service) Act, 1958.

### **3.2.2.3 Perquisites taxable in the case of specified employees Sec17(2)(iii)**

Any expenditure of the employee met by the employer is perquisites in the hands of employees as per section 17(2)(iv). However, in certain cases, the employer provides perquisite in the form of facilities to certain employees. Such perquisites are taxable

only in the hands of such specified employee. The value of any benefits, which is not mentioned in 3.2.2.1 and 3.2.2.2, provided free of cost or at concessional rates are taxable in the hands of specified employees. Following are the example of such perquisites:

1. Sweeper, gardener, watchman or personal attendant provided to employees.
2. Facility of gas, electricity or water supplied by employer.
3. Free or concessional tickets.
4. Motor car
5. Free or concessional educational facilities.

The following category of employees are considered as specified employees:

**(a) Director employee:** An employee who concurrently serves as a director in the employer company, regardless of whether full-time or part-time, and whether maintaining that directorship for the entire year or a portion thereof, is classified as a specified employee.

**(b) Employee having substantial interest in the company:** An employee is considered to possess a substantial interest in the employer-company if he is the beneficial owner of equity shares representing at least 20% of the voting power. He is designated as a specified employee.

**(c) Employee drawing in excess of Rs. 50000:** Any employee not encompassed by the aforementioned conditions whose income taxable under the category of Salaries, inclusive of all monetary compensation from one or multiple employers, but excluding the value of benefits or amenities provided in kind, exceeds Rs 50,000. To ascertain the Rs 50,000 limit, the following are to be excluded or deducted:

- i. All non-monetary benefits.
- ii. Monetary benefits under Section 10
- iii. Standard deduction:
  - a. Upto Rs. 50000, if the assessee opts out of default tax regime provided under section 115BAC(1A).
  - b. Upto Rs. 75000 if the assessee continues to pay tax under default tax regime.
- iv. Entertainment allowance and deduction towards professional tax is also allowed if the assessee opts out of the default tax regime as per section 115BAC(1A).

Note: The valuation of perquisites will be discussed in Unit 3.

### 3.2.3 Deductions and Exemptions

#### 3.2.3.1 Deductions

The following deductions are allowed while calculating the taxable income from salary:



### 1. Standard deduction as per Sec 16 (ia):

- a. Rs 50,000, if assessee opts out of the default regime.
- b. Rs. 75000, if assessee pays tax as per default regime

### 2. Entertainment Allowance as per Sec 16(ii):

The provisions relating to the deduction against entertainment allowance is as follows:

- a. In case of Government employee the least of the following shall be allowed:
  - i. Statutory limit of Rs 5,000
  - ii. Actual amount received
  - iii. 1/5th of basic salary
- b. In case of other employees, Nil

### 3. Employment Tax Sec 16(iii):

Any amount remitted by an assessee for employment tax, imposed by any statute, is permissible as a deduction.

#### 3.2.3.2 Exemptions

##### *House Rental Allowance (HRA) [Section 10 (13A)]*

HRA is a partly exempted allowance and the least of the following is exempt from tax, while computing income from salary:

- a. HRA Actually received.
- b. Rent paid *less* 10% of Salary.
- c. 50% of salary (in the case of accommodation provided in Mumbai, Kolkata, Delhi or Chennai)

40% of salary (in the case of accommodation provided in any other city.)

##### *Special allowance [Section 10 (14)]*

Special allowances are classified into two for the purpose of computing income from salary.

##### 1. Section 10 (14) (i):

Special allowances or benefits specifically granted to meet expenses incurred wholly, necessarily and exclusively in the performance of the duties. Such allowances are exempt upto the actual expense incurred for that purpose. The allowances granted for the purpose of performing duties:

- a. Helper allowance.
- b. Research allowance.
- c. Uniform allowance.
- d. Travelling allowance.
- e. Daily allowance.
- f. Conveyance allowance.

**2. Section 10 (14) (ii):** Special allowances granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment or at the place of residence. This may also include allowance granted to compensate him for the increased cost of living. These allowances include:

- a. Special compensatory (Hilly areas) Allowance, which is exempt upto Rs. 800 or Rs. 300 per month, depending upon the specified locations. The exemption will be Rs. 7000 per month in the case of Siachen area of Jammu and Kashmir.
- b. Border area/remote locality/difficult area/disturbed area allowance, which is exempt upto Rs. 1300, or Rs. 1100, or Rs. 1050, or Rs. 750, or Rs. 300 or Rs. 200 per month depending upon the specified locations.
- c. Special compensatory (Tribal area/Scheduled area/Agency area) allowance [Specified States], which is exempt upto Rs. 200 per month.
- d. Any allowance granted to an employee working in a transport system to meet his personal expenses while performing his duty of running such transport, is exempt upto 70% of such allowance upto a maximum of Rs. 10000 per month. This is allowed only if such employee is not in receipt of daily allowance.
- e. Children education allowance is exempt upto Rs. 100 per month per child upto a maximum of two children.
- f. Hostel allowance, which is exempt upto Rs. 300 per month per child, to a maximum of two children.
- g. Compensatory field areas allowance [Specified areas in specified states], which is exempt upto Rs. 2600 per month.
- h. Compensatory modified field area allowance [Specified areas in specified states], which is exempt upto Rs. 1000 per month.
- i. Counter insurgency allowance, which is exempt upto Rs. 3900 per month.
- j. Underground allowance, which is exempt upto Rs. 800 per month.
- k. High altitude allowance, which is exempt upto Rs. 1060 per month for altitude of 9000 to 15000 feet and upto 1600 per month for above 15000 feet.
- l. Special compensatory highly active field area allowance, which is exempt upto Rs. 4200 per month.
- m. Island (duty) allowance, which is exempt upto Rs. 3250 per month.

## Recap

- ◊ Allowances are the cash payments made by employer to employee on a monthly basis apart from salary.
- ◊ Allowance can be fully taxable, fully exempt and partly exempt.
- ◊ Extra benefits in addition to salary or wages legally due by way of a contract or services rendered is referred to as perquisites.
- ◊ Perquisites may be fully taxable, tax free and taxable only in the hands of specified employees
- ◊ Standard deduction is a statutory deduction from salary available to all individuals.
- ◊ Entertainment allowance, if provided by the employer can be deducted from salary upto prescribed limit.
- ◊ Employment tax remitted by the assessee for employment purpose imposed by any statute can also be deducted from salary.

## Objective Questions

1. Cash payments by an employer on a monthly basis other than salary or wages is known as?
2. Allowance disbursed to employees to offset the increase in price levels is known as?
3. Dearness allowance which is part of employment terms is considered for calculating the exemption limit of HRA. True or false.
4. Which section of the IT Act states the standard deduction available for salaried employees?
5. What is the statutory limit for entertainment allowance as per section 16 (ii)?

## Answers

1. Allowances
2. Dearness allowances/dearness pay
3. True
4. Section 16 (ia)
5. Rs 5000
6. If the assessee claims two house properties as self-occupied, one is considered as self-occupied and the other as deemed to be let out house property
7. No limit

## Assignments

1. Compare and contrast the exemptions provided on allowances under the default tax regime and optional tax regime.
2. State with an example how deductions and exemption reduce the tax burden of an individual.
3. What do you mean by allowances?
4. List out the allowances that are taxable.
5. State those allowances for which dearness pay (forming part of employment terms) is included for calculating exemption threshold.
6. State the perquisites that are exempted only in the hands of specified employees.
7. Describe the category of employees who are considered as specified employees.
8. Write a note on deductions u/s 16.

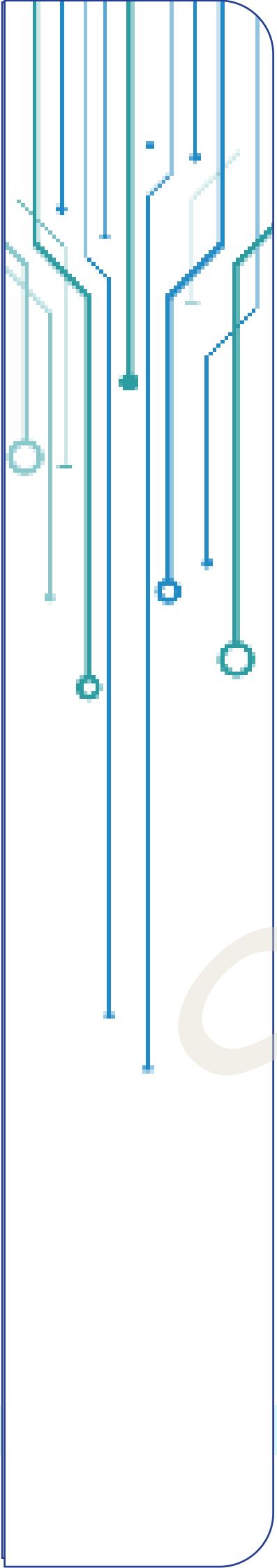
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# Unit 3

## Computation of Salary

### Learning Outcomes

After completing this unit, the learner will be able to;

- ◊ compute the gross salary
- ◊ compute taxable salary
- ◊ identify and calculate the exemptions and deductions available with regard to salary income

### Prerequisites

Salary, as discussed in the previous unit, includes any monetary benefits that are extended to the employee by an employer. It can be in the form of direct monetary payments like wages or allowances provided for meeting the expenses incurred by an employee while performing their duties. Some allowances may also be extended to meet personal expenditures in the case of specified employees. Similarly, some benefits may be extended in cash or in kind to the employee, such as a motor car, rent-free accommodation, children's education allowance, etc. Such cash and non-cash benefits provided to the employee to meet or facilitate meeting his personal expenses are known as perquisites. From the previous units, you must have obtained a considerable understanding of what salary income means and the provisions relating to the taxation of the same. Also, Unit 2 explained the provisions relating to the calculation of various taxable, non-taxable, and partly taxable allowances. The calculation regarding the same will be presented in this unit. In addition, a brief introduction to taxable and tax-free perquisites was also discussed in the previous unit. As mentioned in Unit 2, a detailed presentation of the calculation of perquisites in the process of calculating gross salary will be discussed in this unit. Furthermore, this

unit will be solely dedicated to the presentation of calculating gross salary and taxable income from salary after adjusting for the various exemptions regarding the allowances and perquisites mentioned in Unit 2. You are required to have a thorough understanding of the terms and provisions discussed in Units 1 and 2 before delving into Unit 3.

## Keywords

Basic pay, House rental allowance, perquisite, rent-free accommodation, gross salary, taxable salary.

## Discussion

### 3.3.1 Proforma for computation under the head salary

Proforma for the computation of income from salary is presented in Table 3.3.1, which can be used for the calculation of gross and net taxable salary income of an assessee:

Sl No	Particulars	Amount
1	Basic salary	XXX
2	Fees/commission	XXX
3	Bonus	XXX
4	Allowance	XXX
	(i) Dearness Allowance	XXX
	(ii) House Rental Allowance (HRA)	XXX
	Less: Exemption u/s 10 (13A)	XXX
	(iii) Children allowance	XXX
	Less: Exemption	XXX
	(iv) Children hostel allowance	XXX
	Less: Exemption	XXX
	(v) Transport allowance	XXX
	Less: Exemption	XXX
	(vi) Entertainment allowance	XXX
	(vii) Travelling allowance/daily allowance/conveyance allowance	XXX
	Less: Exemption	XXX
	(viii) Other allowances including overtime allowance, city compensatory allowance etc	XXX

5	Taxable perquisites		xxx
6	Leave travel concession	xxx	
	Less: Exemption u/s 10 (5)	xxx	xxx
7	Gratuity		
	(i) Received during the tenure of employment [Taxable]	xxx	
	(ii) Received at the time of retirement or otherwise	xxx	
	Less: Exemption u/s 10 (10)	xxx	xxx
8	Uncommuted pension		xxx
9	Commutted pension	xxx	
	Less: exemption u/s 10 (10A)	xxx	xxx
10	Leave encashment		
	(i) Received during the employment	xxx	
	(ii) Received at the time of retirement or otherwise	xxx	
	Less: exemption u/s 10 (10AA)	xxx	xxx
11	Voluntary retirement compensation	xxx	
	Less: Exemption u/s 10 (10C)	xxx	xxx
12	Retrenchment compensation etc	xxx	
	Less: Exemption u/s 10 (10B)	xxx	xxx
<b>Gross salary</b>			<b>xxx</b>
Less: Deduction under section 16			
Standard deduction u/s 16 (i)			xxx
Entertainment allowance u/s 16 (ii)			xxx
Professional tax/tax on employment (paid by employer/employee) u/s 16 (iii)			xxx
<b>Income under the head salary</b>			<b>xxx</b>

### 3.3.2 Computation of allowances partly exempt from salary

Allowances that are partly exempt from salary include House rental allowance and special allowances such as travel allowance, hilly area allowance, border area allowance, etc, which were discussed in 3.2.1.2. The exemption allowed with regard to these allowances has been discussed in 3.2.3.2. The calculation of these allowances will be presented by way of practical illustrations in this section.

#### Illustration 3.3.1 (*House Rental Allowance*)

Mr. Muthu Kumar had received the following from his employer:

1. Basic pay – Rs. 40000 pm
2. Dearness allowance (D.A) – Rs. 6000 pm

3. Commission – Rs. 50000 p.a.
4. House rent allowance – Rs. 15000 pm

Calculate the amount of HRA exempts in the hands of Mr. Muthu Kumar assuming that he paid a rent of Rs. 16000 pm for his accommodation at Kanpur. DA forms part of salary for retirement benefits.

### **Solution 3.3.1**

<b>Computation of Taxable HRA</b>	
<b>Particulars</b>	<b>Amount</b>
HRA Received	180000
Less: Exemption u/s 10 (13A)	136800
<b>Taxable HRA</b>	<b>43200</b>

*Calculation of exemption on HRA received:*

Exemption shall on HRA shall be the least of the following:

a. The actual amount received ( $15000 \times 12$ )	180000
b. Excess of the actual rent paid by the assessee over 10% of salary (Rent paid – 10% of salary for the period)	136800
c. $= (16000 \times 12) - 10\% \text{ of } [(40000 + 6000) \times 12] = 192000 - 55200$	
d. 40% of salary as his accommodation is situated in Kanpur	220800
$= 40\% \text{ of } [(40000 + 6000) \times 12]$	

It has to be noted that for the purpose of exemption u/s 10 (13A), dearness allowance is included in salary only when the terms of employment provide so, and excludes all other allowances and perquisites.

### **Illustration 3.3.2 (Special allowances)**

Mr. Altaf has sons. He receives a children education allowance of Rs. 150 pm for his elder son and Rs. 70 pm for his younger son. Both his sons are going to school, and in addition he also received the following allowances:

1. Transport allowance – Rs. 1800 pm
2. Tribal area allowance – Rs. 500 pm

Compute his taxable allowances.

### Solution 3.3.2

Computation of Taxable allowances	
Particulars	Amount
Children education allowance	
Elder son $[(150 - 100) \text{ pm} \times 12] = 600$	
Younger son $[(70 - 70) \text{ pm} \times 12] = \text{Nil}$	600
Transport allowance $(1800 \text{ pm} \times 12)$	21600
Tribal area allowance $[(500 - 200) \text{ pm} \times 12]$	3600
<b>Taxable allowances</b>	<b>25800</b>

### 3.3.3 Provident fund

Provident fund is a scheme intended to give substantial benefits to an employee at the time of their retirement. Though it forms part of retirement benefits, contributions made to the provident fund is significant while calculating the gross/taxable income from salary. So, in this section, we discuss the provisions regarding provident fund and the detailed computation of provident fund at the time of retirement will be discussed in Unit 4.

Under this scheme, a specified sum is deducted from the employee's salary every month or at regular intervals. This is considered as his contribution to the fund. In addition, the employer also contributes to the same. Such contributions of the employer and employee are invested in approved securities. The interest earned from such investments are credited to the account of the employee. Thus, the provident fund account balance of an employee will consist of:

1. Employee's contribution
2. Interest on employee's contribution
3. Employer's contribution
4. Interest on employer's contribution.

The accumulated balance of the provident fund account is paid to the employee at the time of his retirement or resignation. In case the death of the employee, the same will be paid to his/her legal representatives. Provident fund is considered as an important source of small savings available to the Government and thus, the Income Tax Act, 1961 provides certain deductions in connection with the savings in a provident fund account.

#### 3.3.3.1 Types of provident fund

##### *Recognised provident fund (RPF)*

Recognised provident fund (RPF) are funds that are recognised by the Commissioner of Income tax for the purpose of income-tax. It is governed as per Part A of Schedule IV of the Income Tax Act 1961. This schedule puts forward rules relating to the fund such as:



1. Recognition of the fund
2. Employee's and employer's contribution to the fund
3. Treatment of accumulated balance etc.

A fund which is constituted under the Employee's Provident Fund and Miscellaneous Provisions Act, 1952 will also be considered as RPF.

### ***Unrecognised provident fund (UPF)***

UPF means those funds which are not recognised by the commissioner of Income tax.

### ***Statutory provident fund (SPF)***

An SPF is a fund, which is governed by Provident Funds Act, 1925 and applies to the employees of government, railways, semi-government institutions, local bodies, universities and all recognised educational institutions.

### ***Public provident fund***

PPF is functions under the Provident Fund Act, 1968. Eventhough PPF is well suited for self-employed individuals, the membership to PPF is open to every individuals. A salaried employee may also contribute to PPF in addition to the funds operated by his employer. Similarly, an individual can also contribute on his own behalf or on behalf of a minor to whom he is a guardian.

<b>Particulars</b>	<b>RPF</b>	<b>UPF</b>	<b>SPF</b>	<b>PPF</b>
Employer's contribution	Contribution in excess of 12% if salary is taxable u/s 17 (1)	Not taxable at the time of contribution	Fully exempt	N.A
Employee's contribution	Eligible for deduction u/s 80c	Not eligible for deduction	Eligible for deduction u/s 80c	Eligible for deduction u/s 80C
Interest credited on employer's contribution	Amount in excess of 9.5% p.a. is taxable as "salary" u/s 17 (1)	Not taxable at the time of credit of interest	Fully exempt	N.A.
Interest credited on employee's contribution	Amount in excess of 9.5% p.a. is taxable as "salary" u/s 17 (1)	Not taxable at the time of credit of interest	Exempt upto certain limit of contribution	Fully exempt
Amount withdrawn on retirement/ termination	Exempt u/s 10 (12) subject to certain conditions detailed in Fig 3.3.1	Employee's contribution is not taxable  Interest on employee's contribution is taxable under 'income from other sources'  Employer's contribution and interest thereon is salary	Exempt u/s 10 (11)	Fully exempt u/s 10 (11)

**Note:** Salary for the purpose of provident fund means basic salary and dearness allowance, if provided in the terms of employment for retirement benefits and commission as a percentage of turnover.

**Figure 3.3.1**

**Illustration 3.3.3**

Mr. Jothish is working in ABC Ltd. and has furnished the details of his income for the F.Y. 2024-25. You are required to compute his gross salary based on the details provided below:

1. Basic salary – Rs. 10000 pm
2. D.A. (50% is for retirement benefits) – Rs. 8000 pm
3. Commission as a percentage of turnover – 0.1%
4. Turnover during the year – Rs. 5000000
5. Bonus – Rs. 40000
6. His own contribution in the RPF – Rs. 20000
7. Employer's contribution to RPF – 20% of his basic salary
8. Interest accrued in the RPF @ 13% p.a. – Rs. 13000

**Solution 3.3.3**

Computation of Gross Salary of Mr. Jothish for the AY 2025-26		
Particulars	Amount	Amount
Basic Salary [10000 x 12]		120000
Dearness allowance [8000 x 12]		96000
Commission on turnover [0.1% x 5000000]		5000
Bonus		40000
Employer's contribution RPF [20% of 120000]	24000	
Less: Exemption	20760	3240
Interest accrued in the RPF @ 13% p.a.	13000	
Less: Exemption @ 9.5% p.a.	9500	3500
<b>Gross Salary</b>		<b>267740</b>

**Notes:**

Employer's contribution in the RPF payment is exempt up to 12% of the salary ie. 12% of [Basic Salary + Dearness allowance forming part of retirement benefits + Commission based on turnover]

$$\begin{aligned}
 &= 12\% \text{ of } [120000 + (50\% \text{ of } 96000) + 5000] \\
 &= 12\% \text{ of } 173000 \\
 &= 20760
 \end{aligned}$$

Employee's contribution to RPF is not taxable. It is eligible for deduction u/s 80C.

### 3.3.4 Profit in lieu of salary [Section 17 (3)]

The components that form part of Profit in lieu of salary are explained in this section.

#### 3.3.4.1 Compensation on account of termination of employment

The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment.

#### 3.3.4.2 Compensation on account of modification of the terms and conditions of employment

The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the modification of the terms and conditions of employment. Usually, such compensation is treated as a capital receipt and is chargeable as salary.

It is to be noted that merely because a payment is made by the employer to a person who is his employee does not fall within the scope of these provisions. The payment must have arisen due to a master-servant relationship between the payer and the payee. If it is not on that account, but due to considerations totally unconnected with employment, such payment is not profit in lieu of salary.

#### 3.3.4.3 Payment from provident fund or other fund

Any payment due to or received by an assessee from his employer or former employer from a provident fund or another fund, to the extent to which it does not consist of the employee's contributions or interest on such contributions. It does not include the following:

1. Gratuity [Section 10 (10)]
2. Pension [Section 10 (10A)]
3. Compensation received by a workman under Industrial Disputes Act, 1947 [Section 10 (10B)]
4. From provident fund or public provident fund [Section 10 (11)]
5. From recognised provident fund [Section 10 (12)]
6. From approved superannuation fund [Section 10 (13)]
7. Any House Rent Allowance [Section 10 (13A)]

It is to be noted that if any sum is paid to an employee at the time of maturity from an unrecognised provident fund it is adjusted as follows:

- a. That part of the sum which represents the employer's contribution to the fund and interest thereon is taxable under the head 'salaries'.
- b. That part of the sum which represents the employee's contribution is not chargeable to tax as no deduction or exemption was available at the time of contribution.

- c. That part of the sum which represents the interest on employee's contribution is chargeable to tax as 'income from other sources'.

#### 3.3.4.4 Keyman insurance policy

Any sum received by an assessee under a Key man insurance policy including the sum allocated by way of bonus on such policy.

#### 3.3.4.5 Lump sum payment or otherwise

Any amount, whether in lump sum or otherwise, due to the assessee or received by him, from any person:

- a. Before joining employment with that person, or
- b. After cessation of his employment with that person.

### 3.3.5 Valuation of perquisites

#### 3.3.5.1 Rent free accommodation

*Where accommodation is provided by the central government of any state government to the employees either holding office or post in connection with the affairs of the Union or of such State*

**Unfurnished accommodation:** The value of a rent-free furnished residence allocated to the Minister, designated parliamentary officers, or the Leader of the Opposition in Parliament, the value of accommodation shall be the difference between the license fee determined by the Central government or any state government in respect of accommodation in accordance with the rules framed by such government and the rent actually paid by the employee.

**Furnished accommodation:** If the accommodation provided to such employee is furnished then the value of perquisite shall be calculated by adding the value of unfurnished accommodation with:

- a. 10% per annum of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment) [*if the furniture is owned by the employer*], or
- b. The actual hire charges payable for the furniture, reduced by any charges paid or payable for the same by the employee during the PY [*if the furniture is hired from a third party*].

Where the accommodation is provided by any other employer

**Where accommodation is owned by the employer (Furnished):** If the accommodation provided to the employee is furnished and owned by the employer, the value of rent-free accommodation occupied by the employee during the PY shall be determined as follows:

1. 10% of salary in cities having population greater than 40 lakhs as per 2011 census.



2. 7.5% of salary in cities having population greater than 15 lakhs and less than 40 lakhs as per 2011 census.
3. 5% of salary in other areas.

The value so obtained shall be reduced by the rent, if any, actually paid by the employee.

**When the accommodation is owned by the employer (Unfurnished):** If the accommodation provided to the employee is owned by the employer and unfurnished, then the value of rent-free accommodation occupied by the employee during the PY shall be determined by adding the following to the value of furnished accommodation owned by the employer:

1. 10% per annum of the cost of furniture (including television sets, refrigerators, other household appliances, air-conditioning plant or equipment or other similar appliance or gadgets) [*if furniture is owned by employer*]
2. The actual hire charges payable for the furniture, reduced by any actual charges paid or payable for the same by the employee during the PY [*if such furniture is hired from a third party*].

**When accommodation is leased or rented by the employer (Furnished):** If the employer provides a leased or rental accommodation which is furnished, then in such case the perquisite value shall be the least of the following:

1. Actual lease rental amount paid or payable by the employer, or
2. 10% of the salary

This value has to be reduced by the rent, if any, actually paid by the employee.

**When the accommodation is leased or rented by the employer (Unfurnished):** If the employer provides a leased or rented property as accommodation, but it is unfurnished, then in such a case the value of the perquisite shall be determined by adding the value calculated for a similar property which is furnished, with the following:

1. 10% per annum of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air conditioning plant or equipment or other similar appliances or gadgets) [*if the furniture is owned by employer*]
2. The actual hire charges payable for the furniture, reduced by any charges paid or payable for the same by the employee during the PY. [*if such furniture is hired from a third party*]

**Where the accommodation is provided by any employer, whether government or any other employer in a hotel:** When the accommodation is provided in hotel the valuation of perquisite is applicable only in the case of an unfurnished accommodation. Here the value shall be the least of the following:

1. 24% of salary paid or payable for the previous year, or
2. The actual charges paid or payable to hotel

The value so obtained shall be reduced by the rent, if any, actually paid or payable by the employee. However, it has to be noted that, where the employee is provided

with such an accommodation for a period not exceeding in aggregate of 15 days on his transfer from one place to another, there would be no perquisite.

#### ***If the same accommodation is provided for multiple years***

When the same accommodation is provided for more than one year, the valuation in subsequent years shall not surpass the initial year's valuation adjusted by the Cost Inflation Index. The first year refers to the P.Y. or the financial year in which the accommodation was granted to the employee, whichever occurs later. The perquisite value of rent-free accommodation in the following year shall be the lesser of the perquisite value calculated according to the aforementioned rules or the first-year perquisite value adjusted by the Cost Inflation Index. Adjusted first years = First year's perquisite value x CII of the subsequent year / CII of the first year.

#### ***Accommodation provided in a Hotel***

If an employer provides accommodation to an employee in a hotel during a transfer, and the total duration does not exceed fifteen days, the value of such accommodation shall be considered as NIL. In all other instances, the value shall be determined as 24% of the salary disbursed or due for the preceding year, or the actual expenses incurred for such hotel, whichever is lower. If any sum is paid or payable by the employee, it shall be deducted, and the remaining amount shall represent the value of the perquisite.

#### ***Accommodation provided at the site***

If accommodation is provided to an employee at a mining site, onshore oil exploration site, project execution site, dam site, power generation site, or offshore site, and it is temporary, has a plinth area exceeding 800 square feet, and is situated at least 8 kilometers from the boundaries of any municipality or cantonment board, or is located in a remote area, the value of such accommodation shall be considered Nil. A remote area is situated at least 40 km from a town with a population exceeding 20,000, according to the most recent All India Census.

#### ***Accommodation at the Time of Transfer***

In cases where an employee is transferred and provided accommodation at the new posting while retaining accommodation at the previous location, the value of the perquisite shall be assessed based on the accommodation with the lesser value. The value will be assessed based on the benefit accessible for a maximum duration of 90 days, and the value of the perquisite will be applied to both accommodations.

### **3.3.5.2 MOTOR CAR**

#### ***When a vehicle is owned by the employer***

**Car used exclusively for official purpose:** When the vehicle is utilized entirely and exclusively for the execution of official responsibilities. The value shall be considered as zero.

**Car used for private purpose:** When the car is utilized solely for the private or personal

purposes of the employee or any member of their household, the value of the perquisite will be as follows:

Actual amount of expenses incurred on the running and maintenance of motor car	xxxx
Add: Remuneration paid to chauffeur if any - xxxx	
Depreciation @ 10% per annum of the actual cost of motor cars - xxxx	xxxx
	<b>Value of motor car</b> xxxx

**Car used partly for personal purposes and partly for official purposes:** If the motor vehicle is utilized partially for the execution of duties and partially for the personal purposes of the employee or any member of their household, the value of perquisite shall be determined as follows:

*Provided that all expenses related to its maintenance and operation are covered by the employer.*

1. Small car (cubic capacity does not exceed 1.6 litre) Rs 1,800 pm
2. Large car (cubic capacity exceed 1.6 litre) Rs 2,400 pm

Add Rs. 900 pm to the value so obtained if chauffeur is also provided.

*Provided that the expenses for maintenance and operation related to personal use are borne by the assessee.*

1. Small Car Rs 600 pm
2. Large Car Rs 900 pm

Add Rs. 900 pm to the value if chauffeur is also provided.

#### **Where the motor car is leased by the employer**

If a motor car is leased and utilized solely for the private or personal purposes of the employee or any member of their household, the value of the perquisite will be determined as follows:

Actual amount spent on running and maintaining the car	xxxx
Remuneration paid to chauffeur if any	xxxx
Less: Amount charged from employee	xxxx
	<b>Value of motor car</b> xxxx

#### **Where multiple cars are owned or hired by employer**

When an employer owns or hires multiple motor vehicles, and the employee or any household member is permitted to use these vehicles for work purposes, the value of the perquisite shall pertain to one vehicle.

1. Small Car Rs 1,800 pm
2. Large Car Rs 2,400 pm

Add Rs. 900 pm to the value if chauffeur is also provided.

#### ***Where multiple cars are leased or owned by employer***

When an employer owns or leases multiple motor vehicles and permits the employee or any member of their household to utilize these vehicles for personal purposes, the value of the perquisite for the additional vehicles shall be calculated based on the assumption that they are used solely for private purposes. The valuation shall be determined as outlined in the case (a) if the vehicle is owned by the employer, or (b) as described in the case if the vehicle is leased by the employer.

#### ***Car owned by the employee***

In situation where the motor car is owned by the employee, then the valuation of the perquisite will be as described below:

1. The employer covers or reimburses the actual operating and maintenance expenses, and such reimbursement pertains solely to the vehicle's use for official purposes; value shall be considered Nil if the stipulated conditions are fulfilled.
2. When the reimbursement of car expenses is entirely for the personal use of the employee or any member of their household, the value shall be considered equivalent to the amount reimbursed.
3. In instances where the reimbursement of automobile expenses serves both official and personal purposes for the employee or any household member, the perquisite value for a small car shall be the actual expenditure incurred by the employer, minus Rs 1,800 per month, plus Rs 900 per month for a chauffeur, contingent upon the fulfillment of prescribed conditions. For a large vehicle, the perquisite value will be the actual expenditure incurred by the employer, minus Rs 2,400 per month and Rs 900 per month for a chauffeur, if applicable, provided that the stipulated conditions are met
4. If an employee uses an automotive conveyance, other than their personal car, and the employer covers or reimburses the actual operating and maintenance expenses for official use only, the value shall be considered Nil, provided the stipulated conditions are met.
5. Automotive conveyance, excluding the employee's personal car, for which vehicle expense reimbursement is partially allocated for official and partially for personal use by the employee. The value of the perquisite shall be the actual expenditure incurred by the employer, less Rs 900 per month.

#### ***3.3.5.3 Domestic servant***

If the employer reimburses the wages paid to servants appointed by the employee, then such reimbursement will be considered as perquisite in the hands of all employees. However, if domestic servants are engaged by the employer, it will be considered as a perquisite in the hands of specified employees only. The value of such perquisite shall be:



1. The actual cost to the employer.
2. The actual cost in such a case shall be the total amount of salary paid or payable by the employer or any other person on his behalf for such services, which will be reduced by any amount paid by the employee for such services.

#### **3.3.5.4 Gas, electricity or water**

Similar to domestic servants, if the employer reimburses the expenses met by employee in respect of gas, electricity or water connection taken in the name of employee himself, it will be considered as a perquisite in the hands of all employees. However, if the connection is taken in the name of employer then in such case it will be considered as a perquisite only in the hands of specified employee. The valuation will be as follows:

1. **If payment is made to the agency supplying gas, electricity or water:** Sum equal to the amount paid by the employer to the agency.
2. **If supply is made from resources owned by the employer:** Manufacturing cost per unit incurred by the employer.

Any amount paid by the employee in this regard shall be deducted from the value thus arrived.

#### **3.3.5.5 Concessional educational facilities**

Educational facilities will be considered a perquisite in the hands of all employees if the employer reimburses the expenses met by an employee to meet the educational expenses of his children. However, if the education facility is provided in the school maintained by the employer or in any school by reason of his being employment at free of cost or at a concessional rate, it would be perquisite in the hands of specified employees only. The valuation will be as follows:

1. **If the educational institution is owned by the employer:** Cost of such education in a similar institution in or near the locality. However, there would be no perquisite if the cost of such education or the value of such benefit per child does not exceed Rs. 1000 pm.
2. **If free educational facilities are allowed in any other educational institution by reason of his being in employment of that employer:** Same as 1 above
3. **Others:** Amount of expenditure incurred by the employer on that behalf.

#### **3.3.5.6 Concessional tickets**

It refers to any benefit or amenity provided by an employer who is engaged in the carriage of passengers or goods, to any employee or any member of his family for a private or personal journey at free of cost or at a concessional rate. The value of such a perquisite, shall be the value at which such benefit or amenity is offered by such employer to the public, provided if such amenity is provided in any conveyance owned, leased or made available by any other arrangement by such employer for the purpose of transport of passengers or goods. Any amount paid or recovered from the employee for such benefit shall be reduced from the value of the perquisite. However, there would be no such perquisite to employee of an airline or railways.

### 3.3.5.7 Fringe benefits

Fringe benefits provided to employee by employer are also considered as perquisites. Fringe benefits include:

1. Interest free or concessional loan for any purpose made available to employee or his family member during the PY
2. Travelling touring and accommodation
3. Free or concessional food and non-alcoholic beverages
4. Gift, voucher or token in lieu of such gift.
5. Credit card expenses
6. Club expenditure
7. Use of moveable assets
8. Transfer of moveable assets.
9. Other benefits or amenities

#### Illustration 3.3.4

Y Ltd. Provided the following perquisites to its employee Mr. F for the PY 2024-25:

1. Accommodation taken on lease by X Ltd. for Rs. 15000 pm. Rs. 5000 pm is recovered from the salary of Mr. F.
2. Furniture for which the hire charges paid by Y Ltd. is 3000 pm. No amount is recovered from the employee in respect of the same.
3. A car of 1200 cc which is owned by Y Ltd. and given to Mr. F to be used for both official and personal purposes. All running and maintenance expenses are fully met by the employer. He is also provided with a chauffeur.

Compute the value of perquisites chargeable to tax for the AY 2025-26, assuming his salary for perquisite valuation is Rs. 10 lakhs.

#### Solution 3.3.4

Computation of value of perquisites to tax in the hands of Mr. F the AY 2025-26			
Particulars	Amount	Amount	
<b>Value of accommodation at concessional rate</b>			
Actual amount of lease rental paid by Y. Ltd	180000		
10% of salary (10% of 1000000)	100000		
Least of the above		100000	
<b>Less: Rent paid by Mr. F (5000 x 12)</b>		<b>60000</b>	
		40000	
Add: Hire charges paid by Y Ltd. for furniture provided for the use of Mr. F (3000 x 12)		36000	76000
Perquisite value of car owned by Y Ltd. and provided to Mr. F [(1800 + 900) x 12]			32400
<b>Value of perquisites chargeable to tax</b>			<b>108400</b>

### 3.3.6 Practical Problems

#### Illustration 3.3.5(a)

Mr. Jayesh receives the following emoluments during the previous year ending 31.03.2025:

1. Basic pay – Rs. 400000
2. Dearness allowance – Rs. 150000
3. Commission – Rs. 100000
4. Entertainment allowance – Rs. 40000
5. Medical expenses reimbursed – Rs. 25000
6. Professional tax paid – Rs. 2000 (Rs. 1000 was paid by his employer)

Mr. Jayesh contributes Rs. 5000 towards recognised provident fund. He has no other income. determine the income from salary for AY 2025-26, if Mr. Jayesh is a state government employee.

#### Solution 3.3.5

Computation of salary of Mr. F the AY 2025-26	
Particulars	Amount
Basic pay	400000
Dearness allowance	150000
Commission	100000
Entertainment allowance received	40000
Employee's contribution to RPF	0
Medical expenses reimbursed	25000
<b>Gross salary</b>	<b>715000</b>
Less: Deduction u/s 16 (ia)	
Standard deduction upto 75000	75000
Entertainment Allowance	5000
Profession Tax	2000
<b>Income from salary</b>	<b>633000</b>

#### Illustration 3.3.5(b)

Mr. Jose is now working at Cochin on a salary of Rs.6000 p.m. The employer allows him an HRA of Rs.600 p.m. However, the actual rent paid by the employee is Rs.800 p.m. Calculate his taxable HRA .

**Solution:****Computation of Taxable HRA**

<b>HRA actually received (600 * 12)</b>	<b>7200</b>
<b>Less : Exempted HRA u/s 10(13A) * see note below</b>	<b>2400</b>
<b>Taxable HRA</b>	<b>4800</b>

\*Note : Calculation of exempted amount

1. Actual HRA received	7200
2. Rent paid – 10% of salary (9600- 7200 )	2400
3. 40% of salary	28,800

Least amount of Rs.2400 is the exempted HRA.

**Illustration 3.3.5(c)**

During the relevant previous year, Mr.Ravi, a bank employee who is now working at Calicut received Rs.1,50,000 as salary, Rs.30,000 as DA, Rs.5000 bonus and Rs.22500 as HRA. Determine the taxable amount of HRA if the actual rent paid by him for the house occupied by him during the year was Rs.45,000. Calculate his gross salary under normal provisions of the Act

**Solution :3.3.5(c)**

Salary	1,50,000
DA	30,000
Bonus	5,000
HRA Received	22,500
Less : Exempted u/s 10(13A) * see note	22,500
<b>Gross Salary</b>	<b>1,85,000</b>

\*Note

Calculation of exempted amount of HRA

1. Actual HRA Received	22,500
2. Rent paid-10% of salary [ 45000 - 15 000 ]	30,000
3. 40% of salary [ 40% of 150000]	60,000

Least of 22500 is exempted

## Recap

- ◊ Actual HRA or Rent paid in excess of salary or 40 % of salary (50% in the case of Mumbai, Kolkata, or Chennai, whichever is less, is exempted from taxable portion of HRA).
- ◊ Salary after standard deductions u/s 16 is known as Taxable salary or income from salary.
- ◊ Provident fund is a scheme intended to give substantial benefits to an employee at the time of retirement.
- ◊ Recognised provident fund (RPF) are those funds which are recognised by the Commissioner of Income Tax.
- ◊ Accommodation provided to specified employees free of rent is known as rent free accommodation.

## Objective Questions

1. Fund which are not recognised by the Commissioner of Income Tax is known as. (Answer: Unrecognised Provident Fund)
2. State the amount of interest credited on employee's contribution to RPF which is taxable. (Answer: Amount in excess of 9.5% per annum).
3. State how the interest credit on employee's contribution to UPF is treated (Answer: not taxable at the time of credit of interest).
4. Amount exempted in the case of small car which is used for personal and official purposes and the expenses are met by employer. (Answer: 1800pm)

## Answers

1. Unrecognised Provident Fund
2. Amount in excess of 9.5% per annum
3. not taxable at the time of credit of interest
4. 1800pm

## Assignments

1. Write a note on valuation of car as a perquisite?
2. Explain tax implication of various provident fund
3. Prepare a note on valuation of rent free accommodation as a perquisite
4. State how different contributions made to RPF by employer and employee are treated.
5. Briefly explain the valuation of perquisites.
6. Write a note on concessional educational facilities provided to an employee. Write a note on rent-free accommodation provided to an employee.
7. Mr. Arjun earns a basic salary of Rs. 50000 per month and dearness allowance of Rs.10000 pm (Forming part of retirement benefits). Calculate his gross salary.
8. Ms. Priya receives a basic salary of Rs.40000 pm, and HRA of Rs.15000 pm. She pays rent of Rs.12000 pm in Mumbai. Calculate the taxable HRA. Mr. X is employed with AB Ltd. on a monthly salary of Rs.25000pm and an entertainment allowance and commission of Rs.1000pm each. The company provides him with the following benefits:
  - a. A company owned accommodation is provided to him in Delhi. Furniture costing Rs.240000 was provided on 1.8.2024
  - b. A personal loan of Rs.500000 on 1.7.2024 on which it charges interest @ 6.75% p.a. The entire loan is still outstanding (Assume SBI rate of interest on 1.4.2024 was 12.75%)
  - c. His son is allowed to use a motor cycle belonging to the company. The company had purchased this motor cycle for Rs.60000 on 1.5.2021. The motor cycle was finally sold to him on 1.8.2024 for Rs.30000
  - d. Professional tax paid by Mr.X is Rs.2000

Compute the income from Salary of Mr.X for the AY 2025-26.

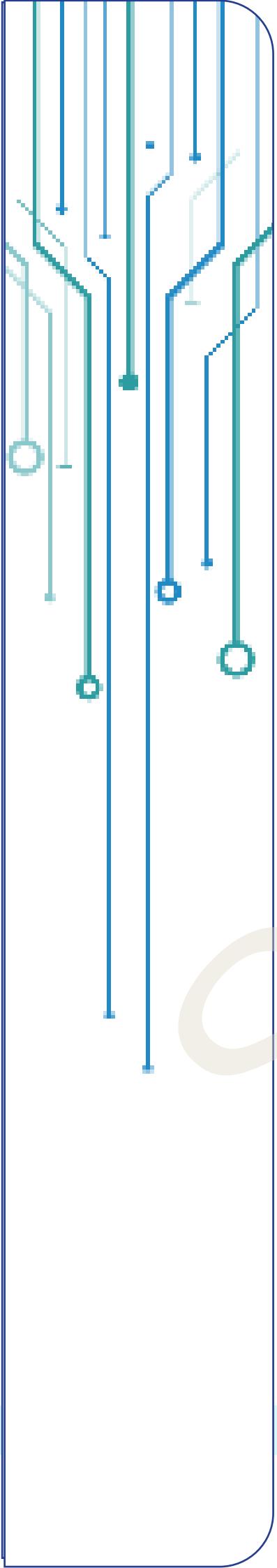
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# Unit 4

## Computation of Income from Salary - Retirement Benefits

### Learning Outcomes

After completing this unit, the learner will be able to;

- ◊ calculate the gratuity taxable under salary
- ◊ compute taxable portion of commuted and uncommuted pension
- ◊ compute the taxable portion of earned leave salary

### Prerequisites

In the last unit we have discussed about the computation of income from salary. To extend the discussion further, this unit present some more provisions relating to salary income at the time of retirement. An employee, at the time of his retirement is entitled to payments such as gratuity, pension, provident fund, leave encashment etc. Under the IT Act a portion or sometimes the whole of such payment would be exempted from tax. In case of partial exemption the rest of the amount with regard to such payment will form part of the salary. In this unit we will discuss the provisions with regard to the payment of gratuity, pensions, provident fund and earned leave salary.

### Keywords

Pension, gratuity, voluntary retirement, encashment of leave, provident fund.

## Discussion

### 3.4.1 Gratuity

Gratuity is a voluntary payment made by an employer in appreciation of services rendered by the employee. Nowadays, gratuity has become a normal payment, which is applicable to all employees. In fact, Payment of Gratuity Act, 1972 is a statutory recognition of the concept of gratuity. Almost all employers enter into an agreement with employees to pay gratuity.

#### 3.4.1.1 Exemption in respect of gratuity [Section 10 (10)]

1. **Gratuity received during the service:** Gratuity received during the time of service is not exempted and is fully taxable.
2. **Gratuity received at the time of retirement/death:** Gratuity received at the time of retirement or death is treated as under:
  - a. *Received under the Pension Code or regulations applicable to members of the Defence Service/Employees of Central Government/Members of Civil Services/local authority employees etc.:* In this case the gratuity received is fully exempt u/s 10 (10) (i).
  - b. *Other employees:* In case of other employees the provision regarding the exemption of gratuity is as under:
    - i. *Covered under the Payment of Gratuity Act, 1972:* If the gratuity provided to other employees is covered under the Payment of Gratuity Act, 1972 the least of the following would be exempt u/s 10 (10)(ii):
      1. Rs. 20 lakhs.
      2. Actual gratuity received.
      3. 15 days' salary<sup>1</sup> (based on last drawn salary) for every completed year of service or part in excess of 6 months (No. of days in a month to be taken as 26)
    - ii. *Not covered under the Payment of Gratuity Act, 1972<sup>2</sup>:* If the gratuity paid is not covered under the Payment of Gratuity Act, 1972 least of the following would be exempt u/s 10 (10) (iii):
      1. Rs. 20 lakh.
      2. Actual gratuity received.
      3. Half month salary<sup>3</sup> (based on average of last 10 months salary) for every completed year of service (fraction to be ignored).

1. Salary for this purpose means basic salary and dearness allowance. No. of days in a month for this purpose, shall be taken as 26
2. Any death cum retirement gratuity received by an employee on his retirement or his becoming incapacitated prior to such retirement or on his termination or any gratuity received by his widow, children or dependents on his death.
3. Salary for this purpose means basic salary and dearness allowance, if provided in the terms of employment for retirement benefits, forming part of salary and commission which is expressed as a fixed percentage of turnover.

### Illustration 3.4.1

Mr. Jithin retired on 15.6.2024 after completing 26 years and 8 months of service. He received a gratuity of Rs. 1500000. At the time of retirement, his salary was:

1. Basic salary – Rs. 50000 pm
2. Dearness allowance – Rs. 10000 pm (60% of which is for retirement benefits)
3. Commission – 1% of turnover (turnover in the last 12 months was Rs. 1200000)
4. Bonus – Rs. 25000 p.a.

Compute his taxable gratuity assuming that:

- a. He is a private sector employee and covered by the Payment of Gratuity Act, 1972.
- b. He is a private sector employee and not covered by Payment of Gratuity Act, 1972.
- c. He is a Government employee.

### Solution 3.4.1

He is a private sector employee and covered by the Payment of Gratuity Act, 1972.

Gratuity received at the time of retirement	1500000
Less: Exemption u/s 10 (10)	
Least of the following:	
-      Gratuity received	1500000
-      Statutory limit	2000000
-      15 days' salary	872308      872308
$\left( \frac{15}{26} \times (50000 + 6000) \times 27 \right)$	
<b>Gratuity received</b>	<b>627692</b>

He is a private sector employee not covered by the Payment of Gratuity Act, 1972.

Gratuity received at the time of retirement	1500000
Less: Exemption u/s 10 (10)	858000
<b>Gratuity received</b>	<b>642000</b>

#### Note: Calculating exemption u/s 10 (10):

When employee is not covered by the Payment of Gratuity Act, 1972 the least of the following will be exempt u/s 10 (10):

Gratuity received: Rs. 1500000

Statutory limit: Rs. 2000000

Half month's salary based on average salary of last 10 months preceding the month of retirement for each completed year of service

$$\left( \frac{1}{2} \times \frac{[(50000 \times 10) + (60\% \times 10) + (1\% \times 1200000 \times \frac{10}{12})]}{10} \times 26 \right) = \text{Rs. 858000}$$

He is a government employee

Gratuity received at the time of retirement	1500000
Less: Exemption u/s 10 (10)	1500000
<b>Taxable gratuity</b>	<b>Nil</b>

### 3.4.2 Provident Fund

Provident fund had been discussed in Unit 3. Here we will discuss the accumulated balance due and becoming payable to an employee.

1. As per section 10 (11), any payment from a Provident Fund (PF) account to which Provident Fund Act, 1925, applies would be exempt. Payment from the Public Provident Fund will also be exempt.
2. Accumulated balance due and payable to an employee participating in RPF would be exempt u/s 10 (12).

However, the exemption under section 10 (11) or 10 (12) would not be available in respect of income by way of interest accrued during previous year to the extent it relates to the amount or the aggregate of amounts of contribution made by that person/employee exceeding Rs. 2500000 in any previous year in that fund, on or after 1<sup>st</sup> April, 2021.

If the contribution by such person/employee is in a fund which there is no employer's contribution, then a higher limit of Rs. 500000 would be applicable for such contribution, and interest accrued in any previous year in that fund, on or after April 2021 would be exempt upto that limit.

It may also be noted that the interest accrued on contribution to such funds upto 31<sup>st</sup> March 2021 would be exempt without any limit, even if the accrual of income is after that date. Exemptions provided u/s 10 (11) and 10 (12) would be available to an assessee irrespective of the regime under which he pays tax.

The CBDT vide rule 9D, notified the manner to calculate taxable interest relating to contribution in a provident fund or recognised provident fund exceeding threshold limit. Interest income accrued during the previous year which is not exempt from inclusion in the total income of a person (taxable interest) shall be computed as the interest accrued during the previous year in the taxable contribution account.

For this purpose, separate accounts within the provident fund account shall be maintained during the previous year 2021-22 and all subsequent previous years for taxable contribution and non-taxable contribution made by a person:

1. Non-taxable contribution account – aggregate of:
  - a. Closing balance in the account as on 31.03.2021
  - b. Any contribution made by the person in the account during the previous year 2021-22 and the subsequent previous years, which is not included in the taxable contribution account, and
  - c. Interest accrued on (a) and (b).
2. Taxable contribution account – aggregate of:
  - a. Contribution made by the person in the account during the previous year 2021-22 and subsequent previous years, which is in excess of the yearly threshold limit, and
  - b. Interest accrued on (a)

The value thus obtained is reduced by the withdrawal, if any, from such account. The yearly threshold limit is Rs. 500000, if the contribution by such person/employee is in a fund where there is no employer's contribution and Rs. 250000 in other cases.

### **3.4.2.1 Exemption of the accumulated balance of RPF, payable to an employee**

In case of RPF, if the employee has rendered continuous service for atleast a period of 5 years with the employer, then the accumulated balance of RPF will be *fully exempt*. But, if the employee have not rendered a continuous service of 5 years with the employer, the accumulated balance of RPF is *exempt* only if his services was terminated due to any of the following:

1. His ill-health
2. Contraction or discontinuance of employer's business
3. Any other cause beyond the control of the employee

If the termination was not due to such reasons, then in such a case the exemption will be provided as described below:

1. If the entire balance standing to the credit of the employee is transferred to his individual account in any RPF maintained with his new employer, the accumulated balance will be exempt. If the balance is not transferred, then the accumulated balance will be taxable.
2. If the entire balance standing to the credit of the employee is transferred to his NPS account referred to in Section 80CCD and notified by the central government, the accumulated balance of RPF will be exempt. In other cases, the accumulated balance will be taxable.

It has to be noted that when the accumulated balance in RPF becomes taxable, the tax payable in each of the years would be computed as if the fund had been an URPF

and the difference in tax would be payable by the employee.

### Illustration 3.4.2

Mr. X retires from service on December 31, 2024 after 25 years of service. Following are the particulars of his income/investments for the previous year 2024-25:

1. Basic pay @ Rs. 16000 per month for 9 months – 144000
2. Dearness pay (50% form part of the retirement benefit) Rs. 8000 per month for 9 months – 72000
3. Lump Sum payment received from the Unrecognised provident Fund – 600000
4. Deposits in the PPF account – 40000

Out of the amount received from the unrecognised provident fund, the employer's contribution was Rs. 220000 and the interest thereon Rs. 50000. The employee's contribution was Rs. 270000 and the interest thereon Rs. 60000. What is the taxable portion of the amount received from the unrecognised provident fund in the hands of Mr. A for the assessment year 2025-26?

### Solution 3.4.2

Taxable portion of amount received from the URPF for AY 2025-26 is computed as follows:

#### Amount taxable under the head salaries:

Employer's share in the payment received from the URPF	220000
Interest on the employer's share	50000
Total	270000

#### Amount taxable under the head "Income from other source":

Interest on the employee's share	60000
<b>Total amount taxable from the amount received from the fund</b>	<b>330000</b>

### 3.4.3 Pension

Pension is a periodic payment made especially by Government or a company or other employers to the employee in consideration of past service payable after his retirement. Such payments can of two types:

1. **Uncommuted pension:** Uncommuted pension means pension received periodically, which is fully taxable in the hands of both government and non-government employees.
2. **Commuted pension:** Commutation means inter-change. Thus, a commuted pension refers to lump sum amount taken by commuting the whole or part of the pension. Many persons convert their future right to receive pension into a lump sum amount receivable immediately.

For example, suppose a person is entitled to receive a pension of Rs. 10000 pm for the rest of his life. He may commute 1/4<sup>th</sup> i.e., 25% of this amount and get a lumpsum of

Rs. 150000. After commutation, his pension will now be the balance 75% of Rs. 10000 pm ie. Rs. 7500 pm.

### 3.4.3.1 Exemption in respect of commuted pension [Section 10 (10A)]

Commutted pension is exempt from tax subject to the specific conditions, and the treatment of the same is described below:

1. For employees of Central govt./local authorities/statutory corporation/member of civil services/defence services the amount of commuted pension is fully exempt u/s 10 (10A) (i).
2. For other employees, if the employee is in receipt of gratuity, the following will be exempt from tax u/s 10 (10A) (ii) (a):

$$\frac{1}{3} \times (\text{Commuted pension received} \div \text{commutation \%}) \times 100$$

In the case of uncommuted pension, the amount is fully taxable. However, if the employee does not receive any gratuity, the following will be exempt u/s 10 (10A) (ii) (b):

$$\frac{1}{2} \times (\text{Commuted pension received} \div \text{commutation \%}) \times 100$$

#### Illustration 3.4.3

Mr. Sagar who retired on 1.10.2024 is receiving Rs. 5000 pm as pension. On 1.2.2025, he commuted 60% of his pension and received Rs. 300000 as commuted pension. You are required to compute his taxable pension assuming that:

1. He is a government employee.
2. He is a private sector employee and received gratuity of Rs. 500000 at the time of retirement.
3. He is a private sector employee and did not receive any gratuity at the time of retirement.

#### Solution 3.4.3

Assuming he is a government employee

Uncommuted pension received (October to March) [(5000 x 4months) + (40% of 5000 x 2 months)]	24000
Commuted pension received	300000
Less: Exemption u/s 10 (10A)	300000 Nil
<b>Taxable pension</b>	<b>24000</b>

Assuming that he is private employe in receipt of gratuity Rs. 500000 at retirement

Uncommuted pension received (October to March) [(5000 x 4months) + (40% of 5000 x 2 months)]		24000
Commuted pension received	300000	
Less: Exemption u/s 10 (10A) $\left(\frac{1}{3} \times \frac{300000}{60\%} \times 100\%\right)$	166667	133333
<b>Taxable pension</b>		<b>157333</b>
Assuming he is a private employee and did not receive any gratuity at retirement		
Uncommuted pension received (October to March) [(5000 x 4months) + (40% of 5000 x 2 months)]		24000
Commuted pension received	300000	
Less: Exemption u/s 10 (10A) $\left(\frac{1}{2} \times \frac{300000}{60\%} \times 100\%\right)$	250000	50000
<b>Taxable pension</b>		<b>74000</b>

### 3.4.3.2 Exemption in respect of pension received by recipient of gallantry awards [Section 10 (18)]

Any income by way of pension received by an individual is exempt from income tax if:

1. Such individual was an employee of Central or State Government and,
2. Has been awarded “Param Vir Chakra” or “Maha Vir Chakra” or “Vir Chakra” or any other gallantry award notified by the Central Government in this regard.

In the case of death of such an individual, any income by way of family pension received by any member of the individual’s family shall also be exempt under this clause. Family for this purpose means:

- a. The spouse and children of the individual, and
- b. The parents, brothers and sister of the individual or any of them, wholly or mainly dependent on the individual.

### 3.4.3.3 Exemption of disability pension to disable personal of armed forces

The entire disability pension i.e., “disability element” and “service element” of pension granted to member of naval, military or air forces who have been invalidated out of the naval, military or air force on account of bodily disability attributable to or aggravated by such service would be exempt from tax.

The Central Board of Direct Taxes (CBDT) has, in Circular No. 13/2019, dated 24.6.2019, clarified that exemption in respect of disability pension would be available to all armed forces personal (irrespective of rank) who have been invalidated out of such service on account of bodily disability attributable to or aggravated by such service. However, such tax exemption will be available only to armed forces personal who

have been invalidated out of service on account of bodily disability attributable to or aggravated by such service and not to personal who have been retired on superannuation or otherwise.

### **3.4.4 Voluntary retirement [Section 10 (10C)]**

Lump sum payment or otherwise received by an employee at the time of voluntary retirement would be taxable as “profits in lieu of salary”. However, it would be exempt under section 10 (10C), subject to the following conditions:

**Eligible undertakings:** The employees of the following undertakings are eligible for the exemption under this clause:

1. Public sector company
2. Any other company
3. An authority established under a Central/State or Provincial Act.
4. A local authority
5. A co-operative society
6. A University established or incorporated under a Central/State or Provincial Act and an Institution declared to be a University by the University Grants Commission.
7. An Indian Institute of Technology.
8. Such Institute of Management as the Central Government may, by notification in the Official Gazette, specify in this behalf
9. Any State Government.
10. The Central Government.
11. An institution, having importance throughout India or in any State or States, as the Central Government may specify by notification in the Official Gazette.

The maximum limit of the exemption must not exceed Rs. 5 lakhs. Such compensation should be at the time of his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or, in the case of a public sector company, a scheme of voluntary separation. The exemption will be available even if such compensation is received in installments.

#### **3.4.4.1 Guidelines**

The scheme should be framed in accordance with such guidelines, as may be prescribed and should include the criteria of economic viability. Rule 2BA prescribes that the exemption under section 10 (10C) would be available to an employee who has completed 10 years of service or completed 40 years of age. However, this requirement is not applicable in case of an employee of a public sector company under the scheme of voluntary separation framed by the company.

The amount receivable on account of voluntary retirement or separation of the



employee must not exceed:

1. The amount equivalent to three months' salary for each completed year of service or
2. Salary at the time of retirement multiplied by the balance months of service left before the date of his retirement or superannuation.

#### Illustration 3.4.4

Mr. Das received voluntary retirement compensation of Rs. 700000 after 30 years and 4 months of service. He still has 6 years of service left. At the time of voluntary retirement he was drawing a basic salary of Rs. 20000 pm and dearness allowance (which forms part of pay) Rs. 5000 pm. Compute his taxable voluntary retirement compensation, assuming that he does not claim any relief under section 89.

#### Solution 3.4.4

Voluntary retirement compensation received	700000
Less: Exemption under section 10 (10C)	500000
<b>Taxable voluntary retirement compensation</b>	<b>200000</b>

#### *Calculating the extent of exemption*

The exemption under section 10 (10C) will be the least of the following:

1. compensation actually received – Rs. 700000
2. statutory limit – Rs. 500000
3. 3 months' salary  $\times$  completed years of service  $[(20000 \div 5000) \times 3 \times 30 \text{ years}]$  – Rs 2250000
4. Last drawn salary  $\times$  remaining months of service left  $[(20000 \div 5000) \times 6 \times 12 \text{ months}]$  – Rs.1800000

#### 3.4.5 Retrenchment compensation [Section 10 (10B)]

The retrenchment compensation means the compensation paid under Industrial Disputes Act, 1947 or under any 'Act', 'Rule', 'Order' or 'Notification' issued under any law. It also includes compensation paid on transfer of employment under section 25F or closing down of an undertaking under section 25FF of the Industrial Disputes Act, 1947.

It may be noted that the compensation on account of termination and due to modification in terms and conditions of employment would be taxable as "profits in lieu of salary". However, the least of the following amount received as retrenchment compensation would be exempt under section 10 (10B):

1. Amount calculated in accordance with the provisions of section 25F of the Industrial Disputes Act, 1947 i.e., 15 days average pay of completed years of

service and part thereof in excess of 6 months. or

2. An amount, not less than Rs. 500000 as may be notified by the Central Government in this behalf.

### **3.4.6 Encashment of earned leave or leave salary**

Generally, employees are allowed to take leave during the period of service. Employees may avail such leave or in case the leave is not availed, the leave may either get lapse or be accumulated for future or allowed to be encashed every year or at the time of termination/retirement. The payment on account of encashment of unutilised leave would be part of the salary. However, section 10 (10AA) provides exemption in respect of amount received by way of encashment of unutilised earned leave by an employee at the time of his retirement, whether on superannuation or otherwise.

#### **3.4.6.1 Exemption of amount received by way of encashment of leave**

1. Encashment during service : It is taxable in full and is to be included under the head salaries.
2. Encashment after retirement : Exemption in the case of earned leave is only given only when the encashment of earned leave is done by the employee at the time of retirement or his resignation.
  - a. Government Employees: The entire amount of leave salary received at the time of retirement from service on superannuation or otherwise, is fully exempt.
  - b. In the case of non govt employees, the exempted amount of leave salary will be the lowest of the following amount u/s 10 (10AA) (ii):
    1. Rs. 2500000
    2. Leave salary actually received
    3. 10 months' salary (on the basis of average salary of last 10 months preceding retirement)
    4. Cash equivalent of unavailed leave (based on last 10 months average salary) to his credit at the time of retirement. Earned leave entitlement cannot exceed 30 days for every year of actual service rendered for the employer whose service he has retired.

Here salary = Basic salary + DA ( if given under the terms of employment) + commission based upon a fixed percentage of turnover achieved by the employee.

#### **Illustration 3.4.6**

Mr. Vineeth was employed in a company. He took voluntary retirement on 1<sup>st</sup> December 2023 after completing 25 years of service. On 1<sup>st</sup> January 2023 his salary was Rs.4,000/- p.m. after adding the annual increment. The total leave availed during service is 10 months and actual amount received is Rs.1,60,000 on encashment. Compute the amount exempt regarding encashment on earned leave?

### **Solution : 3.4.6**

Least of the following is exempted:

Cash equivalent of leave due  $15 * 4000 = 60,000$

10 months average salary  $40,000$

Maximum exemption limit  $25,00,000$

Actual amount received  $1,60,000$

So exempted salary is Rs.40,000.

Note\* total leave available  $= 25 * 1 = 25$  months

Leave availed  $= 10$  months

Leave on credit  $= 15$  months

### **Illustration :3.4.7**

Mr.ghost retires on 31.10.2023 after 20 years of service and he received Rs.1,80,000/- as leave encashment for 12 months . His employer allows him 1&1/2 months of leave for every one year of service. He has already availed leave for 18 months. His salary for 2022-2023 was 15000 and from 1.4.2023 it was raised to 16000 p.m. compute the taxable amount of leave encashment.

### **Solution 3.4.7**

Total leave available  $= 20 * 1.5$

$= 30$  months

Leave availed

$= 18$  months.

Leave due

$= 12$  months( i.e,  $30 - 18 = 12$ )

Calculation of 10 months average salary

Salary from 01-04-2023 to 31-10-2023

$= 16000 * 7 = 1,12,000$

Salary from 01-01-2023 to 31-03-2023

$= 15000 * 3 = 45,000$

Total salary for 10 months

$= 112000+45000 = 1,57,000$

Average Salary

$= 1,57,000 /10 = 15,700$

Least of the following is exempted :

Cash equivalent of leave due  $12 * 15700 = 1,88,400$

10 months average salary  $15700 * 10 = 15,7000$

Maximum exemption limit  $= 25,00,000$

Actual amount received  $= 1,80,000$

Therefor exempted salary is Rs.1,57,000

Taxable amount of salary = 1,80,000 - 1,57,000 = Rs. 23,000

### Illustration 3.4.8

Compute the income from salary of Mr. Justin from the following particulars for the year ended 31.03.2025:

1. He retired on 31.12.2024 at the age of 60, after 25 years and 9 months of service from a private company at Kochi.
2. He was paid a salary of Rs.25000 pm and house rent allowance of Rs.6000 pm. He paid rent of Rs.6500 pm, during his tenure of service.
3. On retirement, he was paid a gratuity of Rs.350000. He was covered by the payment of Gratuity Act, 1972. He had not received any other gratuity at any point of time earlier, other than this gratuity.
4. He had accumulated leave of 15 days per annum during the period of his service; this was encashed by him at the time of his retirement. A sum of Rs.315000 was received by him in this regard. Employer allowed 30 days leave per annum
5. He is receiving Rs.5000 as pension. On 1.2.2025, he commuted 60% of his pension and received Rs.300000 as commuted pension.
6. The company presented him with a gift voucher of Rs.5000 on the retirement. His colleagues also gifted him a mobile phone worth Rs.50000 from their own contribution.

### Solution 3.4.8

Computation income under the head salaries of Mr. Justing for the AY 2025-26		
Particulars	Amount	Amount
Basic Salary – Rs.25000 $\times$ 9 months		225000
House Rent allowance	54000	
Less: Exemption	36000	18000
Gratuity	350000	
Less: Exemption	350000	Nil
Leave encashment	315000	
Less:Exemption	250000	65000
Uncommuted pension $[(5000 \times 1) + (5000 \times 2 \times 40\%)]$		9000
Commuted pension	300000	
Less: exemption	166667	133333
Gift voucher		Nil
Mobile phone received as gift from colleagues		Nil
<b>Gross salary</b>		450333
Less: Standard deduction		75000
<b>Income from salary</b>		<b>375333</b>

## Working Notes:

**Exemption on HRA:** Least of the following

1. HRA received 54000
2. Actualy rent paid in excess of 10 % of salary  $[(6500 \times 9) - 10\% \text{ of } 225000] - 36000$
3. 40% of salary – 90000

**Exemption gratuity:** Least of the following

1. Actual gratuity received Rs. 350000
2. 15 days salary for every year of completed service  $[15/26 \times 25000 \times 26] - \text{Rs.}375000$
3. Notified limit Rs.2000000

**Exemption of leave encashment:** Least of the following

1. 2500000
2. Leave salary actually received Rs.315000
3. Rs.250000 being 10 months' salary x Rs.25000
4. Cash equivalent of leave standing at the credit of the employee based on the average salary of last 10 months  $374/30 \times 25000 - \text{Rs.}312500$

[Leave due = Leave allowed – Leave taken] = 750 (30 days per year x 25 years) – 375 days (15 days x 25) = 375 days]

## Recap

- ◊ Gratuity is a voluntary payment made by an employer in appreciation of services rendered by the employee
- ◊ Pension is a periodic payment made especially by Government or a company or other employers to the employee in consideration of past service payable after his retirement.
- ◊ Lump sum payment or otherwise received by an employee at the time of voluntary retirement would be taxable as “profits in lieu of salary”
- ◊ The retrenchment compensation means the compensation paid under Industrial Disputes Act, 1947

## Objective Questions

1. Gratuity received at the time of service is fully taxable or exempted?
2. What is the maximum amount of gratuity payable under the payment of gratuity act 1972?
3. In the case of government and non government employees, is an uncommuted pension received periodically fully taxable or not?
4. In the case of government employees the entire amount of leave salary received at the time of retirement from service on superannuation or otherwise, is fully exempt? true or false
5. In which section mention exemption in respect of amount received by way of encashment of unutilised earned leave by an employee at the time of his retirement?

## Answers

1. Fully taxable
2. 20 lakhs
3. Fully taxable
4. True
5. Section 10 (10AA)

## Assignments

1. Explain gratuity with an example
2. Discuss the treatment of encashment of earned leave
3. Explain the differences between pension and provident fund
4. Explain exemptions in respect of gratuity
5. What is commuted pension and its tax implications
6. Write a note on retrenchment compensation
7. Briefly explain voluntary retirement scheme

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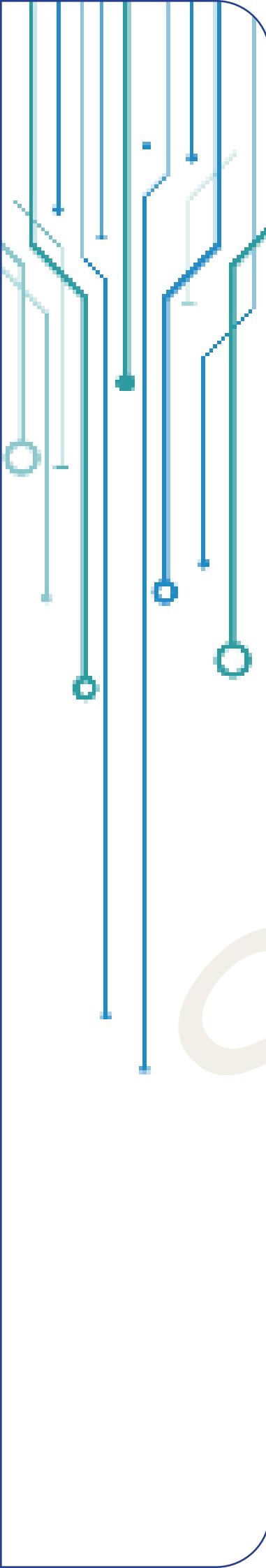
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4  
BLOCK

Income from House  
Property



# Unit 1

## Introduction

### Learning Outcomes

After completing this unit, the learner will be able to;

- ◊ Comprehend the basic concepts of income from house property
- ◊ Gain insight into the determination of Annual Value

### Prerequisites

Arjun, a young professional working in Mumbai, inherited a spacious ancestral house in his hometown after his father's passing. Since he was settled in the city, he left the house unoccupied, assuming there were no financial implications. During the tax filing process, he was informed that under the Income Tax Act, even a vacant house might be considered as having a deemed rental income" This meant that the government could assume the property was generating rental income, and tax could be levied based on its potential market rent. Since Arjun already owned a flat in Mumbai, only one property could be treated as self-occupied, while the other would be classified as "deemed to let be out" and taxed accordingly. To avoid unnecessary tax liability, he explored his options. Selling the house was one possibility, but since he wished to retain it, renting it out became a more practical choice. By doing so, he could generate actual rental income rather than paying tax on an assumed income. Additionally, he could claim deductions, such as municipal taxes and interest on home loans, to reduce the taxable amount. By renting out the property, Arjun ensured it was being utilized while also securing a passive income stream. Over time, he became more aware of property taxation rules and financial planning, turning a potential burden into a well-managed asset. This story throws light on the various aspects of the benefits of letting out house property. This unit discusses the various concepts related to Income from House Property, basis of charge, and the determinants of annual value.

## Keywords

Gross Annual value, Fair Rent, Expected Rent, Standard Rent, Actual Rent

## Discussion

### 4.1.1 Income from House Property

Basis of Charge under the Income from house Property is the annual value of the property. The charging section is Section 22 of the Income Tax Act 1961. Various factors such as municipal value, fair rent, standard rent, and actual rent are considered to arrive at Annual Value. For the computation of income under this head, a house property is classified into three categories : (a) Let-out (b) Self-occupied (c) Deemed to be let-out house property.

### 4.1.2 Basis of Charge (Section 22)

The annual value of the property shall be taxable under the head Income From House Property. According to Section 22 of the Income Tax Act,

The assessee is chargeable to tax on the annual value of the property, consisting of any building or land appurtenant thereto, of which he is the owner and which is not used by him for his own business or profession. Income from house property shall be taxable under this head if the following conditions are satisfied:

1. The property should consist of any building or land appurtenant thereto.
2. The assessee should be the owner of such property.
3. Such property should not be used for the business or profession of the assessee

#### 4.1.2.1 Explanation of the conditions

##### 1. The property should consist of a building or land appurtenant thereto

- a. The income is computed on buildings and land appurtenant thereto under the 'Income from House Property'. This means that the land which is not appurtenant to any building does not come within the scope of this section. Instead such income will be taxable under the head Income from Other Sources instead of Income from House Property.
- b. If it is only vacant land without any building, it will be taxed under the head income from other sources.
- c. The land appurtenant to the buildings comprises of courtyard, play-ground, kitchen-garden, compound etc. If it is a non - residential building, then land appurtenant means play grounds, car parking spaces, drying grounds, connecting

roads in the factory area etc.

- d. In addition to residential houses, buildings may comprise of those buildings let out for office use, warehouses, stadium, open-air-theatre, dance halls, music halls, lecture halls, auditoriums for entertainment programmes cinema halls etc. Building may be located in India or abroad. This means that the income from buildings is taxable under the head Income from House Property even if it is located abroad.
- e. Foreign house property's income will be taxable only in the case of ordinarily residents. However, if during the previous year, income from house property which is situated abroad is received in India, it will be taxable in the case of not ordinarily resident and non-resident also.
- f. If the building is used for own business or profession, the income is computed under the head "Income from business or profession".
- g. In the following cases the income earned will not be taxable under Income from House Property. They are
  - i. Rent collected from business employees who are rented out the building or staff quarter of the assessee will be assessed under the head income from business instead of income from house property.
  - ii. If a building is let out to the concerned authorities in order to locate a bank, post office, police station, etc. them such income will be assessed as income from business instead of house property.
  - iii. If the assessee lets out hire machinery, plant or furniture along with the buildings for a composite rent and the rent of the buildings is inseparable from the rent of the said machinery, plant or the furniture, then such letting is called "Composite letting of building with other assets". Income from Composite letting of building will be taxable under the head "Income from Other Sources" or under the head 'Profits and Gains of Business or Profession', instead of Income from House Property.
  - iv. If the main aim of the assessee's company is to acquire properties and earn income by letting out of same property, then such income is assessable under the Profits and gains of business instead of income from house property.

## 2. On the Annual Value of property

The income from House property is computed based on the annual value of buildings and land appurtenant thereto and not on its rental income.

## 3. The assessee should be the owner of such property

Only the legal owner of a house property is liable to be taxed under the head "Income from House Property." It is the legal ownership which is essential and not beneficial ownership. He may or may not be the beneficiary but must be the legal owner. Tax is based on ownership, not possession or use of the property. If an assessee leases a property and earns income by subletting or re-letting it, such income will not be taxed under this head but under "Income from Other Sources."

Owners of a house property include:

- i. The individual in whose name the property is registered;
- ii. In a mortgage, the original owner (mortgagor) is considered the owner for tax purposes, not the lender (mortgagee).

### **Deemed Owner**

As per section 27 of the Income Tax Act, besides the legal owner, the following persons are also to be treated as deemed owners of house property for the purpose of charging tax on annual value under the head income from house property.

1. Transfer to property to his/her spouse or minor child: The following conditions should be satisfied;

Condition 1: Tax payer should be an individual

Condition 2: He or she transfers a house property

Condition 3: The property is transferred to his or her spouse (not being a transfer in connection with an agreement to live apart) or to his or her minor child (not being a married daughter).

Condition 4: The property is transferred without adequate monetary consideration.

If the above conditions are satisfied, then the individual who has transferred the property would be deemed as the owner of the property.

2. If a member of co-operative society, company or an Association of Persons (AOP) to whom a building or its part was allotted or leased under a house building scheme of the society, then such company or association shall be deemed to be the owner of the property.
3. If a member of an Hindu Undivided Family holds an imitable estate of the family, then he/she shall be deemed to be the owner of the property.
4. A person who is entitled to retain possession of any building in part performance of a contract as per the Transfer of Property Act, 1882, shall be deemed to be the owner of the property.
5. A person shall be deemed to be owner of a property if he takes a land on lease and constructs a house upon it.
6. In case of long-term lease (12 years or more) lessee will be deemed to be the owner till the property is handed over to the lessor.
7. In the case of disputed ownership, the Assessing Officer will decide the ownership for tax purpose.
8. In the case of co-ownership or joint ownership, the share in the property of each member will be separately assessed.
9. If the owner of the property becomes insolvent, the official receiver or assignee will be deemed to be the owner for tax purpose.

#### **(4) The property is not used for the purposes of the Business or Profession of the Assesse**

If an assessee uses a property or part of it for carrying out their own business or profession, and the income from that business or profession is subject to tax, then the annual value of that property (or its used portion) is not taxable under the head "Income from House Property." Additionally, no deduction can be claimed for rent paid on it while calculating the business or professional income.

### **4.1.3 Annual Value**

The term annual value is very important term in the calculation of income from house property. An assessee's income from house property is computed on the basis of annual value. The annual value of a house property is determined not just by the actual rent received, but also by the rent it is expected to earn based on prevailing conditions, and this assessment is done annually. However, if the property is used for self-residence or remains entirely unoccupied during the previous year, and the owner derives no other benefit from it, the annual value is considered to be nil.

#### **4.1.3.1 Determinants of Annual Value**

**Municipal Value:** For the purpose of levying local taxes, the local authorities like panchayaths, municipalities or corporations will fix rental values for their area. For example, Bangalore Development Authority or BDA or Cochin Corporation will fix values of house properties in their areas for charging local taxes like municipal taxes or any local taxes. Thus, Municipal Value is the base for charging local taxes. This, rental value of the property fixed by the municipal authorities for charging local taxes is called the municipal value.

**Fair Rent :** It is the rental value a house property can fetch. It is based on the rent prevailing for a similar type of accommodation in the locality. It is based on the principle that the rent prevailing in the same locality will be more or less similar. Such rental value is called Fair Value. For example, rent for two buildings in the same area with similar facilities will be the same. There cannot be wide variations.

**Standard Rent:** This is the rent fixed by the Rent Control Act. It will be applicable if it is given in the question. This is applicable for areas, which are not fully developed. Therefore, the municipal corporation or the local authorities have not fixed or valued the amount of rent. This will happen only when the area is fully developed. For example, new layouts formed in a locality will not have a standard rent fixed, and it will be fixed as the area develops.

**Actual Rent or De-facto Rent:** It is the rent actually received by the owner of the house property from the tenant. If the tenant pays composite rent, that is rent of building, plant and machinery, furniture, etc., and if the rent is separable, the actual rent is reduced by the amount of rent of plant and machinery or furniture. For example, in the case of a fully furnished apartment, if the rent is Rs 25,000 and the rental value of

furniture is Rs 10,000, the composite rent is Rs 35,000. Actual rent is Rs 25,000, that is Rs 35,000 - Rs 10,000 = Rs 25,000. If the tenant pays property taxes, repairs to the building, insurance or any interest on advance money, these are not included in the actual rent or are not allowed as a deduction in computing income from house property.

**Expected Rent :** Expected rent computation is divided into two, that is, (a) if standard rent has not been fixed, and (b) if standard rent is fixed. The computation is explained below;

### **Determination of Expected Rent**

#### **(a) Where standard rent has not been fixed:**

One of the following (whichever is greater) shall be the expected rent of the building:

- i. Municipal value determined by the local authority for charging house tax, etc.; or
- ii. Fair Rent-Rent of similar properties in the same locality.

#### **(b) Where standard rent has been fixed:**

One of the following (whichever is less) shall be the expected rent of the building:

- i. The value as determined under (a); or
- ii. The Standard Rent fixed under Rent Control Act of a State.

Note: The expected rent cannot be more than the standard rent, but it can be less than the standard rent.

### **Illustration 4.1.1**

Mr. Sanjay has a house in Bangalore, which is let out. (Standard Rent fixed)

Its Municipal Value = Rs 1,08,000 p.a and Fair Rent = Rs 1,20,000 p.a and the Standard Rent is Rs 1,02,000. Compute the Expected Rent.

#### **Solution**

Particulars	Amount(Rs)
a. Municipal Value	1,08,000
b. Fair Rent	1,20,000
c. Between a and b whichever is higher	1,20,000
d. Standard Rent	1,02,000
e. Between c and d Which ever is lower = Expected Rent	1,02,000

### Illustration 4.1.2

Calculate the Expected Rent from the following details . ((Standard Rent not fixed)

Particulars	Situation A(Rs)
Municipal Value	1,20,000
Fair Rent	1,50,000
Standard Rent	Not Available

### Solution

**Table Showing the Computation of Expected Rental Value**

Particulars	Amount(Rs)
Municipal Value	1,20,000
Fair Rent	1,50,000
Expected Rent is (Municipal Value or Fair Rent whichever is higher)	1,50,000

### Some Important Points regarding Income from House Property

- Disputed ownership:** If ownership of a property is under dispute in a court of law, the Income Tax Department has the authority to determine who is considered the owner for tax purposes. Typically, the individual receiving rental income or possessing the property as the owner is recognized as the rightful owner.
- Property owned by co-owners [Section 26]:** When a property is jointly owned by two or more individuals with clearly defined and identifiable shares, the income from the property is not assessed as an Association of Persons (AOP) on such persons. Instead, each co-owner's share of the income is included in their respective total income for tax purposes. If a co-owner occupies a portion of the house for personal residence, that portion is considered self-occupied, and its annual value is treated as Nil, making it exempt from tax.
- Composite rent:** When a building is rented out along with additional facilities (such as electricity, a cooler, a lift, a water pump, and water tax) for a composite rent, the rental income is treated differently for tax purposes. If the rent for the building can be distinctly separated from the rent for these facilities, only the building's rent is taxed under "Income from House Property", while the charges for additional facilities are taxed under "Income from Other Sources." However, if the composite rent cannot be divided, the entire amount is taxed under "Income from Other Sources." In such cases, the cost of these facilities provided by the landlord is deducted from the composite rent to determine the fair rental value.

## Recap

- ◊ Basis of charge under Income from House property is the annual value of the property.
- ◊ The charging section is Section 22 of the Income Tax Act 1961.
- ◊ The three conditions to charge any income under Income from House Property. They are : The property should consist of building or land appurtenant thereto, The assessee should be the owner of such property and Such property should not be used for the business or profession of the assessee.
- ◊ The rental value of the property fixed by the municipal authorities for charging local taxes is called the municipal value.
- ◊ Fair Rent refers to the rent of similar properties in the same locality.
- ◊ Actual Rent or de - facto rent is the actual amount of rent receivable from the tenant.
- ◊ Standard Rent is the rent fixed by the Rent Control Act.
- ◊ If ownership of a property is under dispute in a court of law, the Income Tax Department determines the taxable owner based on possession or receipt of rental income.
- ◊ When a property is jointly owned with clearly defined shares, each co-owner is taxed on their respective share of income, and any self-occupied portion is exempt with an annual value of Nil.
- ◊ If a property is rented out with additional facilities, the rent for the building is taxed under "Income from House Property" and facility charges under "Income from Other Sources," but if separation is not possible, the entire rent is taxed under "Income from Other Sources" with deductions for facility costs.

## Objective Questions

1. Which Section of Income tax Act gives the basis of charge for house property income?
2. If a property is rented out with additional facilities, the rent for the building is taxed under
3. The rent of similar properties in the same locality
4. What is the basis of Charge under the Income from house Property
5. The rent fixed by the Rent Control Act is known as
6. What are the conditions for allowing municipal taxes paid in the computation of income from house property?
7. The rental value of the property fixed by the municipal authorities for charging local taxes is known as
8. The actual amount of rent receivable from the tenant is known as

## Answers

1. Section 22
2. Income from House Property
3. Fair Rent
4. Annual Value
5. Standard Rent
6. Paid by owner only is allowed. Paid by tenant is not allowed. Allowed on actual payment basis and not as per the previous year.
7. Municipal Value
8. Actual Rent

## Assignments

1. Mr. Arnav has a house in Bangalore, which is let out. (Standard Rent fixed) Its Municipal Value = Rs 1,10,000 p.a and Fair Rent = Rs 1,50,000 p.a and the Standard Rent is Rs 1,60,000. Compute the Expected Rent.

2. Elaborate the conditions for charging house property income as per the Income tax Act?
3. Calculate the Expected Rent from the following details.

Particulars	Situation A (Rs)
Municipal Value	1,60,000
Fair Rent	1,80,000
Standard Rent	Not Available

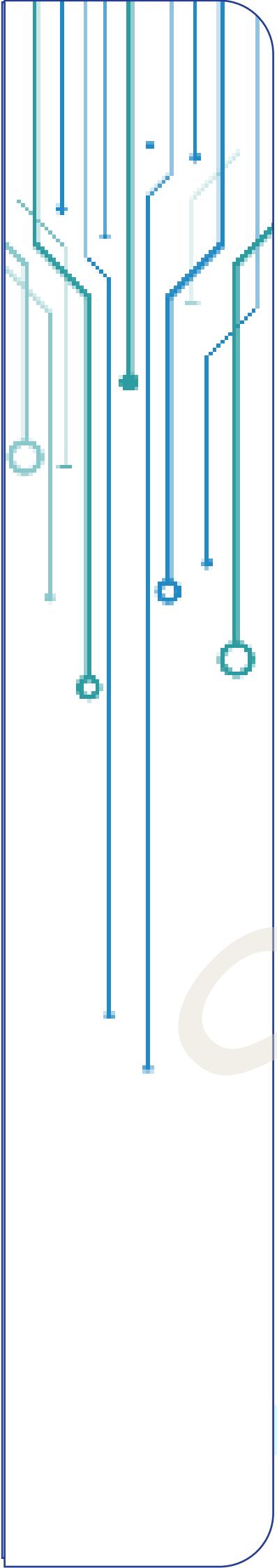
4. Mrs. Seetha has a house in Kolkata, which is let out. (Standard Rent fixed) Its Municipal Value = Rs 1,50,000 p.a and Fair Rent = Rs 1,20,000 p.a and the Standard Rent is Rs 1,30,000. Compute the Expected Rent.
5. Explain in detail the determinants of Annual Value ?
6. Who is a deemed owner?
7. What is the basis of charging income from house property?
8. What do you mean by actual rent?
9. What is Expected Rent
10. What is Fair Rent?
11. What do you mean by composite rent?
12. What do you mean by standard rent?
13. How will you determine Expected Rent ?

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# Unit 2

## Deductions and Exemptions

### Learning Outcomes

After completing this unit, the learner will be able to;

- ◊ understand the meaning of unrealized rent
- ◊ gain insight into deductions and exemptions related to the computation of income from house property

### Prerequisites

Meera, a retired teacher, owned a house in Jaipur that she rented out to earn a steady income. She carefully selected a tenant and signed a rental agreement, expecting timely payments. However, after a few months, the tenant stopped paying rent, citing financial difficulties. Despite multiple reminders, the dues kept piling up, and eventually, the tenant vacated the property without settling the unpaid rent. As tax season approached, Meera was unsure whether she needed to pay tax on the entire rent amount, including the unpaid portion. While discussing her concerns with her accountant, she learned that the Income Tax Act provides relief for unrealised rent, meaning that if certain conditions are met, the unpaid rent can be excluded from her taxable rental income. She had to prove that she had taken reasonable steps to recover the amount and that the tenant had left the property. Additionally, she discovered she was eligible for various deductions. She could deduct municipal taxes paid, claim a standard deduction of 30% on the net annual value to cover maintenance costs, and even deduct interest paid on a home loan if the property was financed. These deductions significantly reduced her taxable income, ensuring she didn't pay more than necessary. Through this experience, Meera realized that understanding tax rules related to let-out property, unrealized

rent, and deductions was crucial for managing rental income effectively. She also became more cautious about tenant selection and documentation to safeguard her finances in the future. This story highlights the various concepts and factors related to the computation of income from house property. This unit discusses about the computation of income from let-out house, unrealised rent and the deductions and exemptions related to the Income from House Property.

## Keywords

Let Out House, Unrealized rent, Deductions, Exemptions

## Discussion

### Exempted House Property Income :

**Following are the exemptions regarding income from house property :**

1. Income from the farmhouse connected with agriculture
2. Annual value of one palace of an ex-Indian ruler
3. Income from property used for assessee's own business or profession.
4. Income from two self-occupied house.
5. Income from house meant for self residence but could not be occupied throughout the previous year on account of his service, business or profession at any other place.
6. Income from property owned by local authority, political party, trade union, charitable trust, hospital, games or sports association, development authority, University, College.

### 4.2.1 Let out House

#### 4.2.1.1 Determination of Gross Annual Value

According to Section 23(1), the annual value of a house property let out shall be deemed to be :

- a. the sum for which the property might reasonably be expected to be lent from year to year: or
- b. where the property or any part of the property is let and the actual rent received or receivable by the owner is in excess of the sum referred to in (a), the amount of rent received or receivable: or

c. where the property or any part of the property is let and was vacant during the whole or part of the previous year, and owing to such vacancy, the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in (a), the amount so received or receivable

### Determination of Gross Annual Value

The Gross Annual Value is determined as follows :

**Step 1:** Compare the Fair Rent or Municipal value. Consider the value whichever is higher

**Step 2 :** Compare the result of Step 1 or Standard Rent. Consider the value whichever is lower. This amount is called Expected Rent.

**Step 3:** Compare Expected Rent or Actual Rent. Here, there are two outcomes.

- ◊ If Actual Rent is greater than ( $>$ ) Expected Rent, then Gross Annual Value will be Actual Rent.
- ◊ If Actual Rent is lower than ( $<$ ) Expected Rent, there are two outcomes
  - i. If Actual Rent is lower than Expected Rent as a result of vacancy, then Gross Annual Value will be Actual Rent.
  - ii. If Actual Rent is lower than Expected Rent as a result of any other factor, then Gross Annual Value will be Expected Rent.

### Municipal Taxes

From the value determined under (a) or (b) or (c) the taxes (including service taxes such as include fire tax, water tax, conservancy tax, health and education cess etc.) levied by any local authority and paid by the owner during the previous year shall be deducted in determining the annual value of the property

### Illustration 4.2.1

From the following details, find out the Gross Annual Value of the let-out house property

Particulars	Amount (Rs)
Municipal Value	2,40,000
Fair Rent	3,00,000
Actual Rent	28,000 PM
Standard Rent	2,70,000

## Solution

Table Showing the Computation of Gross Annual Value

Sl. No	Particulars	Amount (Rs)
a.	Municipal Value	2,40,000
b.	Fair Rent	3,00,000
c.	a or b Whichever is higher	3,00,000
d.	Standard Rent	2,70,000
e.	c or d Which ever is lower – Expected Rent	2,70,000
f.	Actual Rent=28,000x12	3,36,000
g.	Gross Annual Value = e or f Whichever is Higher	3,36,000

## Illustration 4.2.2

Find the gross annual value from the following particulars?

Particulars	A	B	C	D	E
Municipal Value	10,500	10,500	10,500	10,500	10,500
Fair Rent	10,700	10,700	10,700	10,700	10,700
Standard Rent	NA	8,800	8,800	13,500	13,500
Actual Rent	10,000	20,000	10,000	20,000	10,000

## Solution

Table Showing the Computation of Gross Annual Value or GAV

Sl. No	Particulars	A	B	C	D	E
1	Expected Rent	10,700	8,800	8,800	10,700	10,700
2	Actual Rent	10,000	20,000	10,000	20,000	10,000
3	Step 1 or step 2 Value Which ever is higher	10,700	20,000	10,000	20,000	10,700
4	Gross Annual Value	10,700	20,000	10,000	20,000	10,700

### 4.2.1.2 Computation of Net Annual Value

Section 23(1) of the Income Tax Act defines annual value as "the sum for which the property might reasonably be expected to let from year to year" Net annual value is an important component in the computation of income from house property. As you know, and as it has already been mentioned earlier, the net annual value of self-occupied house property is taken as nil for computation. Whereas, the net annual value of let out

house property has to be computed. We compute net annual value from the gross annual value for let-out house properties. From Gross Annual Value, deduct the municipal tax to get Net Annual Value. Municipal taxes are the annual amount paid to the municipal corporation of that area. The conditions for claiming municipal taxes are the following;

- ◊ Municipal tax paid by the assessee is allowed as a deduction.
- ◊ Municipal tax paid is allowed as a deduction on a payment basis, irrespective of the previous year to which it relates.
- ◊ If the owner passes the municipal taxes to be paid by the tenant, it is not allowed as a deduction from the gross annual value.
- ◊ If part of the municipal taxes is paid by the owner and the other part is paid by the tenant, only the taxes paid by the owner will be allowed as a deduction from the Gross annual Value.
- ◊ Other forms of local taxes are; house tax, fire tax, water tax, conservancy tax, education cess, sanitation cess, sewerage tax and any other tax levied by the municipal authority with respect to the house property.

### Illustration 4.2.3

Mr. D furnishes the following details of his house property. Compute the Net Annual Value

Particulars	Amount (Rs)
Rent Received	1,75,000
Municipal Value	1,70,000
Fair Value	1,72,000
Standard Rent	1,60,000
Municipal Taxes	12% of Municipal Value
Sanitation Surcharge	2% of Municipal Taxes

### Solution

Table Showing the Computation of Net Annual Value of Mr. D

Particulars	Amount (Rs)
Municipal Value	1,70,000
Fair Value	1,72,000
Whichever is higher between Municipal Value and Fair Rent	1,72,000
Standard Rent	1,60,000
Expected Rent is 1,72,000 or 1,60,000 Whichever is lower	1,60,000
Actual Rent Received	1,75,000
Gross Annual Value (GAV) =1,60,000 or 1,75,000 Which ever is higher	1,75,000

Less:	20,808
<ul style="list-style-type: none"> <li>Municipal Taxes=12/100 x 1,70,000=20,400</li> <li>Sanitation Surcharge = 20,400 x 2/100 =408</li> <li>Total=20,400+408=Rs 20,808</li> </ul>	
Net Annual Value (NAV) =1,75,000-20,808	1,54,192

#### 4.2.2 Unrealized Rent

According to the Income Tax Act provisions, if the tenant has not paid the rent due to any reason, it is allowed as a deduction for computing Income from House Property as unrealized rent. Thus, unrealized rent is the rent that the owner cannot realize from the tenant and the amount of deduction is equal to the amount of rent payable. For example, if rent is Rs 25,000 per month, unrealized rent for three months =  $25,000 \times 3 = \text{Rs } 75,000$ . Conditions for claiming unrealized rent are the following:

- ◊ Only Unrealised rent of the current year can be claimed.
- ◊ The tenancy is bonafide.
- ◊ The defaulting tenant has vacated the property.
- ◊ The defaulting tenant has not occupied any other house property of the assessee.
- ◊ The assessee has taken all reasonable legal measures for the recovery of the unpaid rent.

#### 4.2.3 Vacancy Allowance

If the property remained vacant during the entire year or part of the year, even after the best efforts of the owner to let out the same, he or she can claim vacancy allowance. Some conditions are to be satisfied as per the Income Tax Act to claim the vacancy allowance, which is given later with the problem. If in the question vacancy allowance is given and it is given that conditions satisfied, then we have to allow vacancy allowance in computing income of house property. This deduction is also the rental value of the property like unrealized rent. For example, if the house property was vacant for six months, and the rental income is Rs.25,000, then the vacancy allowance is  $\text{Rs.}25,000 \times 6 = \text{Rs } 1,50,000$ . There is a difference between vacancy allowance and unrealised rent. In the former case, the house is not occupied as the owner is not getting a tenant. In the latter case, the tenant has occupied the house property, but he or she is not paying rent.

## 4.2.4 Computation of Annual Value of a Let – out House under different situations

### Case I

**Let-out house, which neither remains vacant during part of the previous year nor is there any unrealised rent.**

Here, the gross annual value shall be the expected rent or actual rent, whichever is greater. The municipal tax paid by the owner during the previous year deducted from the gross annual value and the balance shall be the annual value of the property let-out.

### Illustration 4.2.5

Compute the annual value of the house in the following cases:

Particulars	A (₹)	B (₹)
1. Municipal Value	50,000	50,000
2. Fair Rent	1,00,000	1,00,000
3. Standard Rent	60,000	90,000
4. Actual Rent / de facto rent received	150,000	80,000
5. Municipal tax 10% of Municipal Value	Paid by Owner	Paid by Tenant

### Solution :

Computation of Annual Value for the Assessment Year 2024-25

Particulars	A ₹	B ₹
1. Expected Rent	60,000	90,000
2. Actual Rent	150,000	80,000
3. Gross Annual Value (1) or (2) whichever is greater	1,50,000	90,000
4. Less: Municipal Taxes paid by owner	5,000	Nil
Annual Value	1,45,000	90,000

### Case – II

**Let-out house which remains vacant for the whole or any part of the previous year.**

Here, there are two situations

- If the House remains vacant for the full year, then the gross annual value will be nil.
- If House remains vacant for a part of the previous year:
  - The actual rent received/receivable will be the gross annual value if the

actual rent received/receivable for let-out period is more than the expected rent,

- ii. The actual rent received/receivable will be the gross annual value, if the actual rent received/receivable for let-out period is less than the expected rent owing to such vacancy.,

### Illustration 4.2.6

Compute the annual value of the house in the following cases:

Expected rent ₹ 1,90,000

House let-out @ 20,000 p.m.

House tax paid by owner ₹ 18,000

House remains vacant for (a) 1 month, (b) 3 months.

### Solution

#### a. Computation of Annual Value of the House for the Assessment Year 2024-25

Particulars	₹
Actual Rent for 11 months ₹ 2,20,000 is more than expected rent ₹ 190,000	
Gross Annual Value	₹ 220,000
Less: Municipal tax paid	₹ 18,000
Annual Value	2,02,000

#### b. Computation of Annual Value of the House for the Assessment Year 2024-25

Particulars	₹
Actual rent for 9 months ₹ 180,000 is less than expected rent ₹ 190,000 due to vacancy	
Gross Annual Value	₹ 1,80,000
Less: Municipal tax paid	₹ 18,000
Annual Value	₹ 1,62,000

### Illustration 4.2.7

Compute the Gross Annual Value from the following details with vacancy period?

Particulars	Amount (Rs)
Municipal Value	18,000 PM
Fair Rent	22,000 PM
Standard Rent	20,000 PM
Actual Rent	24,000 PM
House Was Vacant for	3 Months

## Solution

Table Showing the Computation of Gross Annual Value

S1. No	Particulars	Amount (Rs)
a.	Municipal Value = $18,000 \times 12$	2,16,000
b.	Fair Rent = $22,000 \times 12$	2,64,000
c.	a or b Whichever is higher	2,64,000
d.	Standard Rent = $20,000 \times 12$	2,40,000
e.	c or d Which ever is lower = Expected Rent	2,40,000
f.	Actual Rent = $24,000 \times 12 - 24,000 \times 3$ (Vacancy)	$2,88,000 - 72,000 = 2,16,000$
g	Gross Annual Value	2,16,000

## Case -III

**Let-out house, which does not remain vacant during any part of the previous year but there is unrealised rent.**

The gross annual value of such a house will be determined as discussed in (Case I). The following deductions will be allowed from the gross annual value, and the balance will be the annual value:

- (a) Taxes which are actually paid by the owner to the local authority,
- (b) Unrealised rent (if conditions of Rule 4 are satisfied).

### Illustration 4.2.8

From the following information, compute the annual value of the house

Municipal value - ₹1,20,000

Fair rent - ₹1,60,000

Standard rent - ₹ 1,40,000

Actual rent - ₹20,000 p.m.

Municipal tax paid by the owner 20% of Municipal Value

Unrealised rent 20,000. Conditions of Rule 4 are satisfied.

### Solution

#### Computation of Annual Value of the House (for the Assessment Year 2024-25)

	₹	₹
(a) Expected Rent	1,40,000	
(b) Actual Rent	2,40,000	
Gross Annual Value (a) or (b) whichever is greater		2,40,000
Less : Municipal Tax	24,000	
Unrealised Rent	20,000	44,000
Annual Value		<b>1,96,000</b>

### Illustration 4.2.9

Compute the Gross Annual Value of the let-out house property with unrealized rent from the following details

Particulars	Amount (Rs)
Municipal Value	30,000 PM
Fair Rent	34,000 PM
Standard Rent	Not Available
Actual Rent	26,000PM
Unrealized Rent	52,000

### Solution

#### Computation of Gross Annual Value

Sl. No	Particulars	Amount (Rs)
A	Municipal Value $30,000 \times 12$	3,60,000
B	Fair Rent $= 34,000 \times 12$	4,08,000
C	a or b Whichever is higher	4,08,000
d.	Standard Rent	Not Available
e.	Expected Rent	4,08,000
f.	Actual Rent Received = Actual Rent - Unrealized Rent $= 26,000 \times 12 - 52,000 = 3,12,000 - 52,000$	2,60,000
g.	Gross Annual Value e or f whichever is higher	4,08,000

#### Case -IV

Let-out house, which remains vacant for part of the previous year, and there is unrealised rent.

The gross annual value of such a house will be determined as discussed in ( Case II ). The following deductions will be allowed from the gross annual value, and the balance will be the annual value:

- i. Taxes actually paid by the owner to the local authority,
- ii. Unrealised rent. (If conditions of Rule 4 are satisfied.)

#### Illustration 4.2.10

From the following information, compute the annual value of the house:

Municipal value - ₹ 3,00,000

Fair rent - ₹2,00,000

Standard rent - ₹2,70,000

Actual rent - ₹ 50,000 per month

The building remained vacant for two month during the previous year.

Unrealised rent ₹ 50,000. Conditions of Rule 4 are satisfied.

Municipal tax paid by the owner 10,000 and by the tenant ₹ 10,000.

#### Solution

##### Computation of Annual Value of the House for the Assessment Year 2024-25

Particulars	₹	₹
(a) Expected rent	2,70,000	
(b) Actual rent (₹6,00,000-1,00,000 vacancy)	5,00,000	
Gross Annual Value		5,00,000
Less : Municipal tax paid by the owner	10,000	
Unrealised Rent	50,000	60,000
	Annual Value	4,40,000

#### Illustration 4.2.11

Compute the Annual Value of the let-out House property with vacancy allowance and unrealized rent from the following details;

Particulars	Amount (Rs)
Municipal Value	30,000 PM
Fair Rent	35,000 PM
Standard Rent	36,000 PM
Actual Rent	40,000 PM
Vacancy Period (Conditions Satisfied)	2 Months
Unrealized Rent (Conditions Satisfied)	1 Month

### Solution

Computation of Gross Annual Value

Particulars	Amount (Rs)
Municipal Value = $30,000 \times 12$	3,60,000
Fair Rent = $35,000 \times 12$	4,20,000
a or b whichever is higher	4,20,000
Standard Rent= $36,000 \times 12$	4,32,000
Expected Rent = c or d Whichever is lower	4,20,000
Actual Rent Received= Actual Rent – Vacancy = $40,000 \times 12$ - $40,000 \times 2 = 4,80,000 - 80,000$	4,00,000
Gross Annual Value (GAV)	4,00,000
Less : Municipal taxes paid by Owner	Nil
Unrealised Rent ( $40,000 \times 1$ )	40,000
Annual Value	3,60,000

### 4.2.4 Computation of Annual Value of Self - Occupied Property

These are the cases

1. (a) House or part of a house occupied by the owner for the full previous year for the purposes of his own residence, [Sec. 23(2)(a)] (b) Unoccupied house. [Sec. 23(2)(b)]
2. House self-occupied for part of the previous year and let-out for part of the previous year. [Sec. 23(3)]
3. More than two houses in the occupation of the owner [Sec. 23(4)]

#### Case -I

##### 1. Self-occupied house or Unoccupied house

The annual value of a house property shall be taken to be nil if the property consists of a house or part of a house which is in the occupation of the owner for the purpose of his own residence or if such property cannot actually be occupied by the owner due to his employment, business or profession carried on at any other place.

### **Deduction from Annual Value. Interest:**

- a. if borrowed capital was used for the acquisition, construction, repair, renewal, or reconstruction of the property, the maximum limit for deduction of interest shall be ₹ 30,000;
- b. if the property is acquired, or constructed using borrowed capital during the period after 31.3.1999, the interest deduction shall be allowed upto ₹ 2,00,000.
- c. However., the acquisition or construction should be completed within five years, from the end of the financial year in which capital was borrowed
- d. The assessee should furnish a certificate from the person to whom any interest is payable on the capital borrowed in order to claim the deduction for interest.

### **Case –II**

#### **House self-occupied for part of the previous year and let-out for part of the previous year [Ser. 23(3)]**

If the house or part of a self –occupied house is actually let during the whole or any part of the previous year, or any other benefit therefrom is derived by the owner, then the annual value of such self-occupied house shall not be nil. In such a case, the house will be treated as let-out house and the annual value will be determined u/s 23(1)

### **Case –III**

#### **More than two houses in the occupation of the owner**

All other houses will be deemed to be let-out if the owner of the houses occupies more than two houses for his residence for the full previous year, except two houses (which he chooses or for which he exercises an option). The income from such deemed to be let-out house(s) shall be in a similar manner to the Computation of Income from Let-out House'. Here, the questions of house remained vacant or unrealised rent or actual rent do not arise. Moreover, the expected rent will be the gross annual value. Moreover, the full amount of interest on the loan taken for acquisition, construction, repairs, and renewal of the house will be allowed as a deduction.

#### **Computation of Income from Deemed Let-out House**

(i) Gross Annual Value	XXX
(ii) Less: Municipal Taxes paid during the Previous Year	(XXX)
<b>Annual Value</b>	<b>XXX</b>
Less: (i) Standard deduction u/s 24(a) (equal to 30% of the annual value)	XXX
(ii) Interest on loan (No limit applies) u/s 24(b)XXX	(XXX)
<b>Income /Loss from House Property</b>	<b>XXX</b>

## 4.2.5 Deductions Under Section 24

While calculating income from house property, two deductions are allowed from Net Annual Value or NAV

- ◊ Standard Deduction Under Section 24(a), and
- ◊ Interest on Borrowed capital / Loan taken in respect of House Property Under section 24(b)

We know that the computation of house property is mainly divided into two, which are;

- ◊ Income from let out house property, and
- ◊ Income from self-occupied house property
- ◊ This can be explained with the help of a diagram given below.

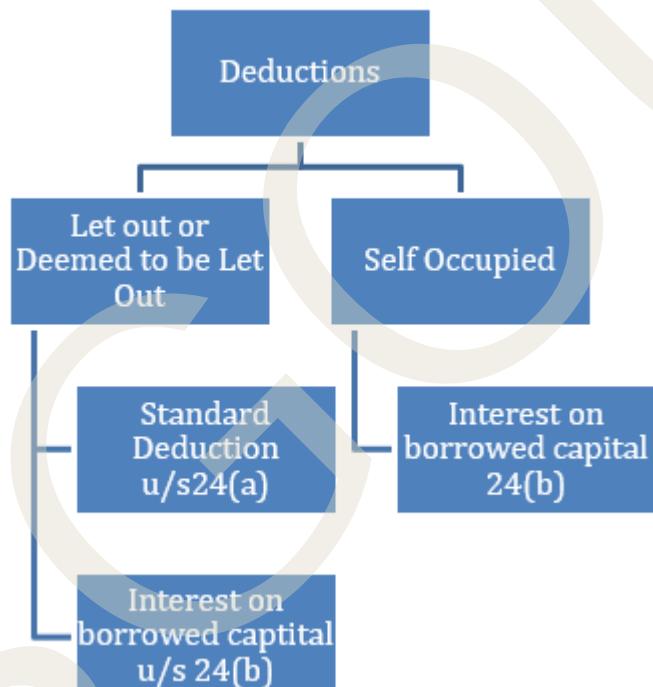


Figure 4.2.1

### 4.2.5.1 Standard Deduction: Under Section 24(a)

This is a flat 30% deduction for let out house properties. This deduction is allowed irrespective of the actual amount spent. This deduction is not allowed to self-occupied house properties, because in that case we are taking the annual value of the house property as nil. This can be explained with the help of the following diagram;

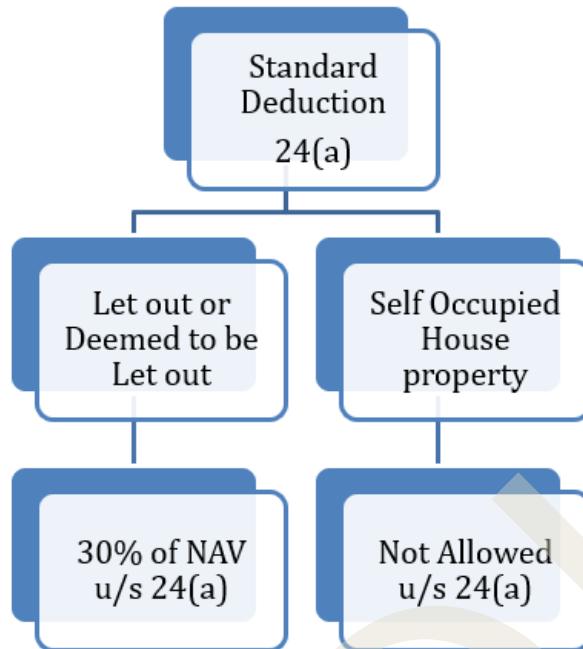


Figure 4.2.2

#### 4.2.5.2 Interest on Borrowed capital/ loan taken in respect of House Property under Section 24(b)

##### (i) Let –Out House

###### (a) Loan for the construction, purchase, repair or renovation of the house property

- ◊ Housing loan taken for the construction, purchase, repair or renovation of the house property shall be allowed as a deduction . It shall be allowed on an accrual basis.
- ◊ No deduction shall be allowed for unpaid interest.
- ◊ Interest on fresh loan to repay the original loan is also allowed as a deduction. This rule is applicable, even if the first loan was an interest-free loan, which is deductible.

###### (b) Pre-Construction Period Interest

Pre-construction period refers to the period prior to the previous year in which property is acquired or construction is completed. It starts from the date of loan taken up to the end of financial year preceding the year in which the construction of house property has been completed or date of repayment of loan. Preconstruction period interest refers to the interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed or repayment of loan whichever is earlier. It can be claimed as deduction over a period of 5 years in equal annual instalments starting from the year of acquisition or completion of construction and for the next four years. Pre-construction period interest is not allowed, if the loan is utilized for repairs, reconstruction or renewal of house property.

For example, if Mr. A has taken a loan on 01.04.2018 as a housing loan and the construction was completed on 01.08.2020. Then the pre-construction period will start from the date of borrowing the loan and end on 31st March immediately preceding the year of completion of construction or acquisition of house property. So, in this case, the pre-construction period is from 01.04.2018 to 31.03.2020. Thus, the assessee can claim pre - constitution period for two years 2018-19 and 2019-20

**Note :**

The interest for the previous years prior to the current year, which is to be deducted in five equal annual instalments, shall be deducted in addition to the interest of the current year.

**Illustration 4.2.12**

Compute the duration of pre-construction period for calculating the interest on loan taken to construct the house property in each of the following cases. Assume in all the cases, the loan is still outstanding.

<b>Case :</b> <b>Date of Loan taken</b>	<b>Date of Completion</b>
(A) 01.02.2021	31.03.2023
(B) 01.01.2022	01.04.2024
(C) 01.09.2022	31.08.2023
(D) 01.11.2021	01.11.2023

**Solution**

**Case (A):** In this case, construction of house property has been completed on 31.03.2023. The pre-construction period will be from 01.02.2021 up to 31.03.2022 i.e. 14 months.

**Case (B):** In this case, construction of house property has been completed on 01.04.2024. The pre-construction period will be from 01.01.2022 up to 31.03.2024. i.e., 27 months.

**Case (C):** In this case, construction of house property has been completed on 31.08.2023 . The pre-construction period will be from 01.09.2022 up to 31.03.2023 i.e., 7 months.

**Case (D):** In this case, construction of house property has been completed on 01.11.2023. The pre-construction period will be from 01.11.2021 up to 31.03.2023. i.e, 17 months.

**Illustration 4.2.13**

Mr. Manu takes a loan of ₹ 50,000 @ 20% p.a. for constructing a house on 1.6.2018. Construction of the house is completed on 20.1.2024. Date of loan repayment is 30.9.2021. Compute the duration of pre-construction period and the amount of interest.

## Solution

Mr. Manu has repaid the loan prior to 31.3.2023 [ie., 31st March occurring prior to completion of construction).

The pre-construction period begins with 1.6.2018 till date of repayment i.e., 30.9.2021.

So pre-construction period = The period from 1.6.2018 to 30.9.2021

Deduction for interest shall be allowed in 5 equal annual instalments beginning with the year of completion of construction which is the Previous Year 2023-24.

Interest Calculation:

Period from 1.6.2018 to 30.9.2021 = 40 months

$$\begin{aligned} &= 50,000 \times \frac{20}{100} \times \frac{40 \text{ months}}{12} \\ &= ₹33,333 \end{aligned}$$

## ii) Interest on Loan taken for Self- Occupied House Property

- ◊ Gross annual value of the self-occupied house property is taken as nil.
- ◊ Interest on loans taken for the acquisition, construction, repairs, renewal or reconstruction of house properties is allowed as a deduction.
- ◊ The interest on loan taken for house property in the case of self-occupied house property can be sub divided into two headings – Loan taken before 1-4-99 and Loan taken after 1-4-99.
- ◊ If the loan is taken before 1-4-99, the interest on loan is allowed up to a maximum of Rs 30,000.
- ◊ If the loan is taken after 1-4-99, the maximum amount of deduction allowed is Rs 2,00,000.

## Conditions for Claiming Interest on Loan For Self-occupied House Property

- ◊ Construction or acquisition of the house property is completed within five years from the end of the financial year in which capital was borrowed.
- ◊ The assessee has to obtain a certificate from the lender stating the amount of principal and interest repaid and the purpose of taking the loan
- ◊ If the loan is taken for repairs, purchase, construction etc. and if the construction is not completed within five years of taking the loan, the deduction is restricted to Rs 30,000 per annum, even if the loan is taken after 1-4-99
- ◊ If the assessee is claiming exemption for two houses, as self-occupied, the total deduction for both the houses will be restricted to Rs 2,00,000 per annum
- ◊ Total deduction in the case of self-occupied house or houses, pre-construction period and post construction period interest together will be restricted to Rs 2,00,000 per annum
- ◊ Interest on money borrowed for payment of municipal taxes is not allowed as

- a deduction
- ◊ Loan taken to repay outstanding interest on old housing loan is not allowed as a deduction

This can be summarized in the following diagram;

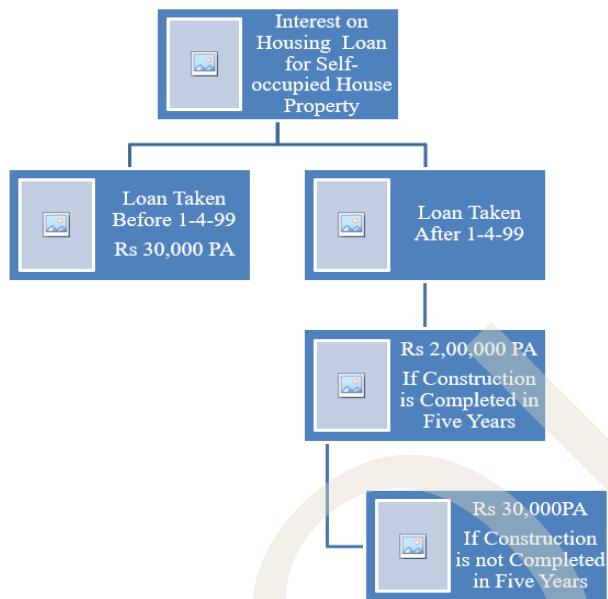


Figure 4.2.3

#### Illustration 4.2.13

Interest on loan of ₹ 4,00,000 taken on 1.4.2021 @ 10% p.a. to construct a house is 40,000 for the Previous Year 2023-24. The construction of the house was completed in the Previous Year 2023-24. Interest for the preceding two years was also paid but not claimed as a deduction. Compute for the Assessment Year 2024-25, the amount of interest deductible in computing the income from house property if the house is let-out, and (ii) self-occupied.

#### Solution

(i) Calculation of Interest deductible in the case of Let-out house:	
Interest for the Previous Year 2023-24	40,000
Interest for 2 years prior to the current previous year (during which the construction of the house is completed)	
₹ 80,000 deductible in 5 equal instalments	16,000 56,000
(ii) Calculation of Interest deductible in the case of self-occupied house	
The deduction shall be allowed to the extent of ₹ 56,000.	

Note : The loan is taken after 31.3.1999. Hence, interest is deductible upto ₹ 2,00,000.

#### Illustration 4.2.14

Mr. Farhan took a loan of 20 lakh @ 10% p.a. on 1.7.2021 for constructing a house. The construction of the house was completed in the Previous Year 2023-24. Compute

the amount of interest deductible in computing the income from house property for the Assessment Year 2024-25 if the house is (i) let-out, (ii) self-occupied.

### Solution

(i) Calculation of Interest deductible in the case of House let-out:	
Interest for the Previous Year 2023-24	2,00,000
Interest from 1.7.2021 to 31.3.2023 ₹3,50,000	<u>70,000</u>
(Deductible in five equal instalments)	<u>2,70,000</u>
(ii) Calculation of Interest deductible in the case of Self-occupied :	
The deduction shall be allowed to the extent of ₹ 2,00,000 only.	

## 4.2.6 Exemptions regarding Income from House Property

House Property Incomes, which are exempted from Tax, can be classified into two. They are

### 1. Fully Exempted Incomes

- Income from farm house
- Annual Value of one palace of ex-Indian Ruler. [Section 10(19A)]
- Income from property owned by Local Authority; Scientific Research Association; Trade Union; Charitable Trust; Political Party; University or other educational institution existing for educational purposes and net purposes of profit; Hospital or medical institution existing for philanthropic purposes and not for the purposes profits.
- Income from property used for assessee's own business or profession.
- Income from two self-occupied house.
- Income from house meant for self-residence but could not be occupied throughout the previous year on account of his service business or profession at any other place.

### 2. Deductible from Gross Total Income

- Income of a co-operative society from the letting of godowns or warehouses for storage commodities meant for sale.[Sec. 80P(2)]
- Income of a co-operative society from house property, provided its gross total income does not exceed 20,000 and the society is not a housing society, urban consumers' co-operative society, transport society or society manufacturing goods with the aid of power.

## Recap

- ◊ Net annual value of self-occupied house property is taken as nil for computation.
- ◊ Whereas, the net annual value of let out house property has to be computed.
- ◊ Net annual value is computed from the gross annual value for let-out house properties.
- ◊ From Gross Annual Value, municipal tax is deducted to get Net Annual Value.
- ◊ Municipal tax paid by the assessee is allowed as a deduction.
- ◊ If the owner passes the municipal taxes to be paid by the tenant, it is not allowed as a deduction from gross annual value.
- ◊ If part of municipal taxes paid by owner and other part paid by tenant only the taxes paid by the owner will be allowed as a deduction from Gross annual Value.
- ◊ Unrealized rent is the rent that the owner cannot realize from the tenant and the amount of deduction is equal to the amount of rent payable.
- ◊ If the property remained vacant during the entire year or part of the year, even after the best efforts of the owner to let out the same, rent during vacancy is allowed as deduction.
- ◊ While calculating income from house property, two deductions are allowed from Net Annual Value or NAV - Standard Deduction Under Section 24(a), and Interest on Borrowed capital Under section 24(b)
- ◊ Standard deduction u/s 24 (a) is a flat 30% deduction from Net Annual Value for let out house properties. This deduction is not allowed to self-occupied house properties.
- ◊ Housing loan taken for the construction, purchase, repair or renovation of a let out house property shall be allowed as a deduction
- ◊ Preconstruction period interest refers to the interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed or repayment of loan whichever is earlier.
- ◊ Pre-acquisition or pre-construction period interest for funds borrowed for the acquisition or construction of house property shall be deducted in five equal annual installments commencing from the previous year in which the house was acquired or constructed for let – out house property under Section 24(b).

- ◊ Interest on loan taken for acquisition, construction, repairs or reconstruction of house properties are allowed as a deduction for self –occupied house property under Section 24(b).
- ◊ If the loan (in case of self –occupied property) is taken before 1-4-99, the interest on loan is allowed up to a maximum of Rs 30,000.
- ◊ If the loan (in case of self-occupied property) is taken after 1-4-99, the maximum amount of deduction allowed is Rs 2,00,000.

## Objective Questions

1. What are the deductions allowed under section 24?
2. What is the rule for allowing standard deduction in the computation of income from house property?
3. What is the percentage of standard deduction allowed for let out house property in the computation of income from house property.?
4. What is the Gross Annual Value of self- occupied house property in the computation of income from house property?
5. What is section 24(a) of income tax Act?
6. What is Section 24(b) of Income Tax Act?
7. What is the limit for interest on loan for self-occupied house property in the computation of income from house property?

## Answers

1. Two deductions. Standard Deduction and interest on money borrowed for constructing or purchasing the house property
2. Allowed only for let out house property. Self-occupied house property this deduction is not allowed
3. 30% of Gross Annual Value
4. Nil
5. Standard deduction
6. Interest on borrowed capital
7. No limit

## Assignments

1. Explain the deductions under Section 24.
2. Explain the exemptions related Income from House Property.
3. Explain the determination of Gross Annual Value and Net Annual Value.
4. Explain the Computation of Annual Value of a Let –out House under different situations
5. Mr. Shyam is the owner of four houses, which are all let out and are covered by the Rent Control Act. From the following particulars compute the gross annual value in each case, giving reasons for your answer:

Particulars	I	II	III	IV
	₹	₹	₹	₹
1. Municipal Value	40,000	36,000	45,000	40,000
2. Fair Rent	46,000	38,000	40,000	46,000
3. Standard Rent	40,000	45,000	46,000	50,000
4. Actual Rent / de facto rent	50,000	40,000	42,000	42,000

6. Compute the Net Annual Value of the following house properties using the following information

(Value's in 000's and Annual Values)

PARTI CULARS	House Property 1 ₹	House Property 2 ₹	House Property 3 ₹	House Property 4 ₹	House Property 5 ₹	House Property 6 ₹	House Property 7 ₹
Municipal Value	60,000	61,000	60,000	80,000	80,000	1,40,000	1,40,000
Fair Rent	65,000	66,000	65,000	78,000	78,000	1,50,000	1,50,000
Standard Rent	59,000	59,000	63,000	85,000	76,000	1,20,000	1,20,000
Actual Rent	72,000	60,000	72,000	72,000	---	96,000	1,44,000
Un realized rent	6,000	3,000	6,000	NIL	----	4,000	12,000
Loss Due to Vacancy	6,000	5,000	NIL	9,000	----	8,000	6,000

7. What is unrealized rent?

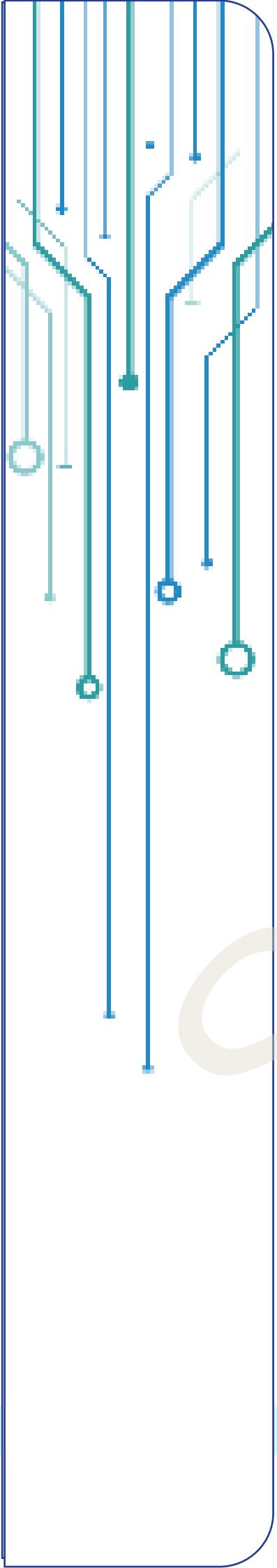
8. What is vacancy allowance?
9. What is standard deduction?
10. What do you mean by deemed to be let out house property?
11. What is composite rent?

## Reference

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## Suggested Reading

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# Unit 3

## Computation of Income from House Property

### Learning Outcomes

After completing this unit, the learner will be able to;

- ◊ understand the computation of Taxable Income from House Property

### Prerequisites

Amit inherited a house in Mumbai while living in his own flat in Pune. He rented out the inherited house but didn't consider the tax implications. When filing his taxes, he realized Income from House Property wasn't just the rent received; it was based on the Annual Value, which could be influenced by municipal valuation, fair rent, or even notional rent if left vacant. He also learned about deductions like municipal taxes paid, a 30% standard deduction, and home loan interest. His tenant had defaulted on rent for a few months, but he discovered that unrealized rent could be excluded under certain conditions. Additionally, since he owned more than one house, only one could be considered self-occupied (with no taxable value), while the other was deemed let-out and taxed accordingly. Confused by these complexities, Amit consulted a tax expert who guided him in properly computing taxable income and claiming deductions. From then on, he maintained accurate records to avoid last-minute tax surprises. This unit discusses about the computation of taxable income from House Property.

## Keywords

Income from House Property, Annual Value , Let –out

## Discussion

### 4.3.1 Computation of Taxable Income from House Property

As we know the computation of taxable income from house property can be mainly divided into two. They are;

- ◊ Let -out house properties, and
- ◊ Self-occupied house properties

#### 4.3.1.1 Computation of Income from Let-out House Property

Particulars	Amount (Rs)	Amount (Rs)
Gross Annual Value		XXX
Less: Local Taxes paid by the owner during the previous year	XXX	
Unrealised Rent	XXX	XXX
Net Annual Value		XXX
Less: (i) Standard Deduction u/s 24(a)	XXX	
(ii) Interest on loan, taken for purchase, construction or repair of the house, relating to previous year u/s 24(b)	XXX	
(iii) Interest on loan for the period prior to the previous year in which the house is completed is also allowable in five equal annual instalments u/s 24(b)	XXX	XXX
Taxable Income from House Property		XXX

### 4.3.1.2 Computation of Income from Self-occupied House

- a. Gross Annual Value-Nil
- b. Municipal Taxes paid by owner during previous year-Not deductible
- c. Annual Value-Nil
- d. Standard Deduction for expenses-Nil
- e. Interest on Loan-Deductible upto 30,000 or ₹ 2,00,000, as the case may be
- f. Loss from self-occupied house

This loss can be set-off against income from other house property or under any other head of income.

#### Illustration 4.3.1

Compute income from let out house property from the following details;

Particulars	Amount(Rs)
Municipal Value	1,80,000
Actual Rent Received	2,40,000
Municipal taxes (50% paid by tenant)	18,000
Expenses incurred on repairs;	
By the owner	30,000
By the tenant	30,000
Rent collection charges	10,000
Date of completion of the house	01-06-2019

#### Solution:

##### Computation of Income from Let out House Property

Particulars	Amount (Rs)
Gross Annual Value (Municipal Value or Actual Rent Which ever is higher )	2,40,000
Less: Municipal Taxes paid by owner	9,000
Annual Value	2,31,000
Less: Standard Deduction 30% of Annual Value $=2,31,000 \times 30/100$	69,300
Income from let out house property	1,61,700

**Note:** Municipal Taxes Paid by tenant is not allowed.

#### Illustration 4.3.2

Mr. A submits the following information about the let out commercial property. Compute his income from let out house property?

Particulars	Amount (Rs)
Municipal Value	1,44,000 p.a
Fair Rent	1,48,000 p.a
Standard Rent	1,60,000 p.a
Actual Rent	1,92,000 p.a
Municipal Taxes	14,400 p.a
Interest on loan taken for the purchase of the house property	45,000

### Solution

Computation of Income from Let Out House Property of Mr. A

Particulars	Amount (Rs)	Amount (Rs)
Gross Annual Value		1,92,000
Less: Municipal Taxes		14,400
Annual Value		1,77,600
Less: Deductions u/s 24		
a. Standard Deduction=30% of 1,77,600	53,280	
30/100x1,77,600		
b. Interest on Loan taken for construction	45,000	98,280
Income from House property		79,320

### Illustration 4.3.3

Mr. Aditya is the owner of a house property in Delhi. Its Municipal Value is ₹ 65,000; Fair Rent is ₹ 90,000, and Standard rent is ₹ 80,000. It has been let out for ₹ 1,00,000 pa. The municipal tax payable by the owner comes to ₹ 10,000 but the landlord has taken an agreement from the tenant stating that the tenant would pay the tax directly to the municipality. The landlord, however, bears the following expenses on the tenant's amenities under an agreement:

Water charges - ₹2,000

Lift maintenance - ₹2,000

Lighting of stairs - ₹1,000

Gardener's salary - ₹1,500

The landlord claims the following deductions:

Repairs - ₹20,000

Land revenue - ₹1,000

Collection charges - ₹1,000

Legal expenses incurred in connection with the purchase - ₹3,000  
of land on which the house is built

Compute the taxable income from house property for the Assessment Year 2024-25.

**Solution:**

**Computation of Taxable Income from House Property (for the Assessment Year 2024-25)**

	₹
Gross annual value of the property is calculated as under:	
Rent realised	1,00,000
Less: Value of tenant's amenities provided by the landlord:	
(i) Water charges	2,000
(ii) Lift maintenance	2,000
(iii) Lighting of stairs	1,000
(iv) Gardener's salary	1,500
	6,500
Actual Rent	93,500
Gross Annual Value	93,500
Less: Municipal tax paid by the owner	Nil
Annual Value	93,500
Less: Standard deduction u/s 24(a) (equal to 30% of the annual value)	28,050
Taxable Income from House Property	65,450

**Note:**

1. Other expenses are not deductible.
2. As the municipal taxes are not borne by the owner no deduction has been made on this account.

3. Calculation of Gross Annual Value

(a) Expected rent-Municipal Value ₹65,000 or Fair Rent ₹ 90,000, but not more than Standard Rent ₹80,000 = ₹80,000

(b) Actual Rent ₹ 93,500.

Gross Annual Value (a) or (b), whichever is greater = ₹ 93,500.

### 4.3.2 Property held as Stock-in-Trade [Sec. 23]

If a property, including any building or land appurtenant thereto, is held as stock-in-trade and remains wholly or partly unlet during the entire previous year, then its annual value will be considered nil for up to two years from the end of the financial year in which the completion certificate for the property's construction is received from the competent authority.

### 4.3.3 Loss From House Property

If the total deductions allowed under Section 24 exceed the annual value of a house property, it results in a loss from house property. This loss can be adjusted against income from any other house property. If the loss is not fully offset, the remaining amount can be set off against income from other heads in the same financial year. Any unabsorbed loss that still remains can be carried forward for up to 8 assessment years, but it can only be adjusted against future income from house property.

For a self-occupied house, if there is a loss due to interest on a home loan, up to ₹30,000 or ₹2,00,000 (as per eligibility), this loss is first set off against income from house property. Any remaining unadjusted loss can then be offset against income under any other head. However, if the loss is still not fully adjusted, it can be carried forward for 8 assessment years and can only be set off only against income from house property.

#### Illustration 4.3.4

Mr. Ridhin has a house property let-out for residential purposes. The following are the details of the property let-out:

Municipal rental value 8,700 p.m.

Actual rent realised ₹ 10,000 p.m.

Rent payable under Rent Control Act ₹ 8,600 per month.

The rent payable for a similar house is ₹ 9,000 p.m.

He has paid 18% of the municipal valuation as local taxes.

The construction of the property began in September 2018 and was completed in February 2021. He had borrowed a loan for the construction of the house property, on which he has paid ₹ 2,00,000 as interest up to 31.3.2023 and 50,000 as interest during the previous year. Fire Insurance Premium paid 3,000 p.a.

Compute the income from house property for the Assessment Year 2024-25.

## Solution

### Computation of Income from House Property (for the Assessment Year 2024-25)

Particulars	₹
Gross Annual Value (Actual rent is more than expected rent)	1,20,000
Less: Municipal Tax	21,600
Annual Value	98,400
Less: Standard deduction: 30% of Annual Value ₹ 29,520	
Interest for previous year	₹50,000
1/5th of Interest	₹40,000
Loss From House Property	1,19,520
	(21,120)

Note : No Deduction except standard deduction and interest on loan

### Illustration 4.3.5

Compute the income from let out house property of Mr. A from the following particulars?

Particulars	Amount (Rs)
Rent realizable from the property=27,000x12	3,24,000
Municipal taxes to be paid by the owner	9,000
The property is on leasehold land and the annual lease rent	30,000
Rent collection charges	1,000
The property was mortgaged for taking a loan for his partnership firm and the amount of loan is Rs 10,00,000@12%	10,00,000
This property was vacant for two months and the rent paid month was Rs 27,000 per month	27,000

## Solution

### Computation of Income From Let out House Property of Mr. A for the Assessment Year 2024-25

Particulars	Amount (Rs)	Amount (Rs)
Actual Rent (27,000x12 - 27,000x2 Vacancy )(324000 -54000)		
Gross Annual Value		2,70,000
Less: Municipal Taxes		9,000
Annual Value		2,61,000
Less: Deductions under section 24		
Standard Deduction=30% of 2,61,000	78,300	78,300
Interest on Loan	NIL	
Income From House property		1,82,700

**Note:** Interest on loan taken for partnership is not allowed as a deduction under section 24.

### Illustration 4.3.6

The following particulars of a residential house completed on 31<sup>st</sup> may 2019 are given below. Compute the income under the head income from house property?

Particulars	Amount (Rs)
Rent	80,000 p.m
Municipal Taxes Paid	18,000
Ground Rent	500
Insurance	800
Interest on loan taken for construction of this house property	1,00,000
Collection charges paid	300
Unrealized rent of earlier years (Conditions satisfied)	20,000
The assessee mortgaged this house property for his daughter's wedding	10,00,000

Compute Income from House Property?

## Solution

### Computation of Let out House Property for the Assessment Year 2024-25

Particulars	Amount(₹)	Amount (₹)
Rent Received=80,000x12		9,60,000
Less: Unrealized Rent		(20,000)
Gross Annual Value		9,40,000
Less: Municipal Taxes		(18,000)
Annual Value		9,22,000
Less: Deductions Under Section 24		
a. Standard Deduction=30% of NAV=9,22,000x30/100	2,76,600	
b. Interest on loan taken for construction of house property	1,00,000	(3,76,600)
Income from Let out House Property		5,45,400

### Illustration 4.3.7

On the basis of the following information compute annual value of the house:

1. Half of the house is self-occupied;
2. Half of the house let-out for ₹8,000 p.m.;
3. Municipal value of the house is ₹ 1,50,000 on which tax is paid @ 20%.

## Solution

### Computation of Annual Value of the House (for the Assessment Year 2024-25)

Particulars	Amount(₹)
Annual Value of self-occupied portion	Nil
Gross Annual Value of let-out portion (Expected rent ₹ 75,000 or actual rent ₹ 96,000; whichever is more)	96,000
Less: Municipal tax paid $\frac{1}{2}$ of $(1,50,000 \times 20/100)$	15,000
Annual Value	81,000

### Illustration 4.3.8

**Compute the annual value of the house of Mr Tarak for the Assessment Year 2024-25:**

1. Two-third portion of the house is self-occupied;
2. One-third portion of the house let-out for ₹ 5,000 p.m.;
3. During the previous year, the let out portion remained vacant for three months and the tenant did not pay the rent for one month. The landlord could not fulfil the conditions regarding the claim for unrealised rent.
4. Municipal tax paid ₹ 39,000. Municipal value 1,20,000.

### Solution

#### Computation of Annual Value of the House (for the Assessment Year 2024-25)

Annual Value of self-occupied portion	Nil
Gross Annual Value of let-out portion (60,000-15,000)	45,000
Less: Municipal tax paid 1/3 of 39,000 13,000	13,000
Annual Value	32,000

#### Notes:

1. The assessee could not fulfil the conditions regarding unrealised rent, hence it is not deductible in computing value.
2. Gross Annual Value of let-out portion has been computed as under: (i) Expected rent of one-third portion  $40,000 \cdot (120000 \times \frac{1}{3})$   
(ii) Actual rent for let-out period 45,000.

Gross Annual Value (i) or (ii), whichever is greater- 45,000.

### 4.3.4 Negative Annual Value

When the municipal tax paid by the owner are more than the gross annual value, the annual value of let-out house or deemed let-out house can be negative

### 4.3.5 Rent received in Arrears or Unrealised Rent Realised

The amount of rent received in arrears or the amount of unrealised rent realised subsequently by an assessee shall be charged to Income-tax in the financial year in which such rent is received or realised whether the assessee is the owner of the property or not in that financial year.

From the amount of arrears of rent received or unrealised rent realised subsequently, 30% of shall amount shall be allowed as deduction.

### Illustration 4.3.9

Mr. Arun let-out a house to Mr. Balram on 1.4.2016 @ ₹ 4,000 p.m. for five years. After the expiry of five Mr. Balram refused to vacate the house. Hence, Mr. Arun filed a suit to get the house vacated and incurred expense of Rs. 2,000 in this connection. Later on Mr. Arun agreed to renew the tenancy for five years w.e.f. 1.4.2021 if Mr. Balram pays him rent @ 5,000 p.m. from 1.4.2021. Balram agreed to it and paid the arrears of rent from 1.4.2021 to 31.3.2023 on 1.6.2023.

Mr. Arun paid the following amount during the previous year:

- i. House tax ₹ 5,000,
- ii. Insurance premium ₹ 900,
- iii. Ground rent ₹ 400.

Compute the income from house property for the Assessment Year 2024-25.

### Solution

#### Computation of Income from House Property (for the Assessment Year 2024-25)

	₹
Gross Annual Value (Rent received @ ₹ 5,000 p.m.)	60,000
Less: Municipal Tax	5,000
Annual Value	55,000
Less: Standard deduction u/s 24(a) (equal to 30% of the annual value)	(16,500)
	38,500
Add: Arrears received from 1.4.2021 to 31.3.2023 @ ₹ 1,000 p.m.	24,000
Less: 30% of arrears received	(7,200)
Income from House Property	(16,800)
	21,700

### Illustration 4.3.10

From the following information, compute the income from self-occupied house property of Mr. A for the assessment year 2024-25?

Particulars	Amount (Rs)
Municipal Rental Value	1,20,000
Fair Rental Value	1,80,000
Municipal Taxes	12,000
Ground Rent	5,000
Interest on loan taken for the construction of this house property	1,00,000

### Solution

Table Showing the Computation of Income from Self- occupied House Property income of Mr. A for the Assessment Year 2024-25

Particulars	Amount (Rs)	Amount (Rs)
Annual Value		NIL
Less: Deductions Under Section 24		
a. Standard Deduction	NIL	
b. Interest on loan taken for construction of this house property	1,00,000	
Loss from self-`occupied house property		(1,00,000)

### Illustration 4.3.11

Compute the income from house property, from the following particulars for the assessment year 2024-25?

Particulars	Amount (Rs)
Municipal Value	24,00,000 p.a
Actual Rent Received	30,00,000 p.a
Municipal Taxes	24,000 p.a
Date of Loan	1-4-16
Date of Completion	31-3-2020
Annual housing loan interest	1,50,000 p.a
Interest on delayed payment of interest	10,000
Date of letting the house property	1-4-2023
Fire insurance premium due	4,000 p.a
Ground rent due	6,000 p.a

## Solution

### Computation of Income From House Property for the Assessment Year 2024-25

Particulars	Amount (Rs)	Amount (Rs)
Gross Annual Value		30,00,000
Less: Municipal Taxes		(24,000)
Annual Value		29,76,000
Less:		
a. Standard Deduction=30% of annual Value = $29,76,000 \times 30/100$	8,92,800	
b. Interest on loan for the current previous year	1,50,000	
c. Pre-construction period interest	1,20,000	(11,62,800)
Income from House property		18,13,200

### Working Notes

- Interest on delayed payment of loan, ground rent due and fire insurance premium due are not allowed as deduction for computation of income from house property.
- Table Showing the Computation of Pre-Construction Period Interest or PCI**

Particulars	Amount (Rs)
Date of loan	1-4-16
Date of completing construction	31-3-2020
Annual housing loan interest	1,50,000 p.a
Pre- construction period	1-4-16 to 31-3-2020
Assessment years allowed for PCI	2020-2021 2021-2022 2022-2023 2023-2024 2024-2025
Total Pre-construction period interest= $1,50,000 \times 4$	6,00,000
Annual pre-construction period interest= $6,00,000/5$	1,20,000
Pre-construction period interest for this assessment year	1,20,000

### Illustration 4.3.12

Mr. A owns a building which consists of two identical units. One is self-occupied and one is let out. The construction was completed on April 1<sup>st</sup> 2019 and the buildings were occupied on the same date. The details of the property are given below, Compute

income from house property for the assessment year 2024-25?

Particulars	House Property 1 (Self Occupied) ₹	House Property 2 (Let out House Property) ₹
Fair Rent	60,000 p.a	60,000 p.a
Rent Received		72,000 p.a
Municipal taxes paid	3,000	5,000
Municipal taxes due and paid on 15-6-2020	3,000	5,000
Land revenue due and paid on 15-6-2020	1,200	1,200
Amount of housing loan: 5,00,000		
Rate of Interest 12% p.a		
Date of Loan 1-4-19		

### Solution

#### Computation of Income from Let Out House Property for The Assessment Year 2024-25

Particulars	House Property 1(Self Occupied) ₹	House Property 2 (Let out House Property) ₹
Gross Annual Value	-	72,000
Less: Municipal Taxes		(5,000)
NAV	NIL	67,000
Less: Deductions Under Section 24		
a. Standard Deduction=30% of NAV=67,000x30/100=	Nil	(20,100)
b. Interest on loan for the current Assessment Year (60000/2) for each unit	(30,000)	(30,000)
c. Pre Construction Period Interest (12000/2 ) for each unit	(6,000)	(6,000)
Income from House Property	(36,000)	10,900
Total Loss from Income from house property= Rs 36,000+Rs 10,900	(Loss)	(Income)
		(25,100)

## Working Notes

### Computation of Pre- Construction Period Interest

Particulars	Details
Date of loan : 1-4-19	
Annual interest = $5,00,000 \times 12/100$ = Rs 60,000	
Pre-construction Period: 1-4-19 to 31-3-2020	
Pre-construction period=60,000/5	Rs.12,000
Pre-construction period is claimed in the following years	2020-21 2021-22 2022-23 2023-24 2024-25
Current year pre construction period interest	Rs.12,000

### Illustration 4.3.13

From the following particulars, compute the income from house property of Mr. Arun for the assessment year 2024-25. Let out house property was completed on 1-9-2015

Particulars	Self-Occupied	Let-Out
Municipal Value	12,000	24,000
Fair Rent	18,000	NA
Actual Rent Received	NA	30,000
Municipal Taxes	1,200	2,400
Ground Rent	500	2,400
Interest on loan for the AY 2020-21	10,000	10,000
Interest on loan for AY's 15-16 to 19-2020	NIL	15,000 p.a
Fire insurance premium	Nil	2,000
Income from other sources Rs 50,000		

## Solution

### Computation of Income From House Property of Mr. A for the Assessment Year 2021-22

Particulars	SELF OCCUPIED	LET- OUT House Property
Gross Annual Value	NA	30,000
Less: Municipal taxes	---	2,400
Annual Value		27,600
Less: Deductions under Section 24		
a. Standard Deduction=27,600x30/100		(8,280)
b. Interest on loan for this AY	10,000	(10,000)
c. Preconstruction period Interest (5 Years Over)	NIL	NIL
Income/ Loss from house property	(10,000)	9,320
Total loss from House property=(Rs. 10,000) + Rs. 9,320 = Rs 680		

### Illustration 4.3.14

Mr X owns two houses in that, one portion is let out and the other portion is occupied by him for his own residence. The municipal value of the let-out house property is Rs 5,20,000 and that of self-occupied house property is Rs 2,60,000. The municipal taxes of both the houses amounted to Rs 60,000. Rent received for the let-out house property is Rs 60,000 PM. The other expenses of both the houses were as follows;

Particulars	Amount (Rs)
Insurance premium for both the houses	12,000
Annual charges for the self-occupied house property	3,000
Ground rent for the let-out house property	1,000
Repairs for the self-occupied house property	7,000
Interest on loan taken to repair both the house properties	40,000
Income from other sources	2,00,000

Compute income from house property of Mr X and his total income.

## Solution

### Income From House Property of Mr X for The Assessment Year 2024-25

Particulars	SELF-OCCUPIED House Property	LET-OUT House Property
Municipal Value		5,20,000
Rent Received=60,000x12		7,20,000
Gross Annual Value		7,20,000
Less: Municipal Taxes		40,000
Annual Value	NIL	6,80,000
Less: Deductions Under Section 24		
a. Standard Deduction = 30% =6,80,000x30/100		2,04,000
b. Interest on loan taken for the construction of house property	13,333	26,667
Loss/Income from house property	(13,333)	4,49,333

## Notes

- ◊ Municipal taxes are divided on the basis of Municipal Rental Value. That is  $60,000 \times 2/3 =$  Rs 40,000. The municipal rental value is  $2,60,000 : 5,20,000 = 1:2$
- ◊ Interest on loan taken to construct the house property is also divided on the basis of municipal rental value, that is 1:2. For self-occupied house property, the interest on loan  $= 40,000 \times 1/3 =$  Rs 13,333 Similarly, the interest on loan taken for the construction of the let-out house property  $= 40,000 \times 2/3 =$  Rs.26,667.

### Statement Showing the Total Income Computation of Mr X for the Assessment Year 2024-25

Particulars	Amount (Rs)
Loss from self-occupied house property	(13,333)
Income from let-out house property	4,49,333
Income from other sources	2,00,000
Total income	6,36,000

## Illustration 4.3.15

Mr. Kamal is the owner of a house at Agra, particulars in respect of which for the year ended 31st March 2024 are as below: 8

1. Actual rent received - ₹9,000
2. Municipal valuation - ₹8,000
3. Total municipal tax - ₹700
4. Municipal tax paid by Mr. Kamal - ₹500

5. Municipal tax paid by the tenant - ₹200
6. Interest on loan taken for renewing the house - ₹3,000
7. Unrealised rent allowed in the Assessment Year 2020-21 recovered during the year - ₹1,000

**Compute Mr. X's Income from house property for the Assessment Year 2024-25.**

**Solution**

**Computation of Income from House Property (for the Assessment Year 2024-25)**

	₹
Gross Annual Value (Actual Rent being higher than E.R.)	9,000
Less: Municipal Taxes paid by owner	500
Annual Value	8500
Less: Standard deduction u/s 24(a) (equal to 30% of the annual value)	2550
Interest on loan u/s 24(b)	3,000
Income from House Property	₹2950
Recovery of Unrealised Rent	1000
Less : 30% of ₹1000	300
	₹700

Hence, Income from House Property: ₹2950 + ₹700 = ₹3650

**Illustration 4.3.16**

Mr Sanjay has two houses, and the particulars of the house properties are given below. Compute income from house property?

Particulars	HOUSE A	HOUSE B
Nature of the house property	Self -Occupied	Let -out
Rent Received	Nil	1,72,000 p.a
Standard Rent	5,00,000 p.a	1,50,000 p.a
Municipal Valuation	4,90,000 p.a	1,60,000 p.a
Fair rent	5,00,000 p.a	1,80,000 p.a
Municipal Taxes paid	49,000 p.a	16,000 p.a
Fire Insurance premium due	5,000 p.a	3,000 p.a
Ground rent paid	4,500 p.a	3,900 p.a
Interest on loan taken during 1998-99	36,000 p.a	48,000 p.a
Unrealized rent	NIL	6,000

## Solution

### Computation of Income from House Property of Mr S for the Assessment Year 2024-25

Particulars	Self-Occupied	Let-Out
Municipal Value		1,60,000
Fair Rent		1,80,000
Municipal Value or Fair Rent Which ever is higher		1,80,000
Standard Rent		1,50,000
ARV= 1,80,000 or 1,50,000 Whichever is Lower		1,50,000
Rent Receivable		1,72,000
ERV = 1,50,000 or 1,72,000 Which ever is higher		1,72,000
Less: Unrealised Rent		6,000
GAV		1,66,000
Less: Municipal Taxes		16,000
Annual Value	NIL	1,50,000
Less: Deductions under section 24		
a. Standard Deduction=30% of NAV=1,50,000x30/100	NIL	45,000
b. Interest on loan taken for house property	30,000	48,000
Loss/Income from house property	(30,000)	57,000
Total income from house property= (30,000) +57,000 = Rs 27,000		

#### Note

Interest on loan for self-occupied house property is restricted to Rs 30,000 as the loan is taken before 1-4-99.

#### Illustration 4.3.17

Mr. Jayadhar owns three houses in Kolkata city. He got a house as gift from a widow on the condition that she will be paid 12,000 per annum for her maintenance throughout her life. The house has been let out at 2,500 p.m. and the municipal taxes paid ₹3,000. The value of the second house according to municipal records is 14,800 and Standard rent ₹15,000, but it has been let out at 1,600 p.m. and the tenant has undertaken to bear the cost of repairs. Municipal taxes paid amounted to ₹ 2,000. The third house, which was constructed in 1.1.2018 with a borrowed capital of ₹ 1,50,000 @ 10% per annum interest from a firm in Sydney (Australia), is occupied by Mr. Hari Kishan as his residence. The municipal valuation of this house is ₹8,000 per annum, and a 10% municipal tax is levied, but it could not be paid during the year. The outstanding loan as of 1.4.2023 was ₹1,20,000, and no amount was repaid from the capital sum during

the year. Interest has been remitted to the Sydney firm without deducting any tax from it, and there is no person in India who can be treated as the agent of that firm in India. Compute his income from house property for the Assessment Year 2024-25.

### Solution

#### Computation of Income from House Property (for the Assessment Year 2024-25)

	₹	₹
First House		
Gross Annual Value (Actual rent)	30,000	
Less: Municipal Taxes	(3,000)	
Annual Value	27,000	
Less: Standard deduction u/s 24(a)	(8,100)	
Income from First House		18,900
Second House		
Gross Annual Value (Expected rent 14,800 or actual rent 19,200, whichever is greater)	19,200	
Less: Municipal Taxes	(2,000)	
Annual Value	17,200	
Less: Standard deduction u/s 24(a) (equal to 30% of the annual value)	5160	
Income from Second House		12,040
Third House: (Self-occupied)	Nil	Nil
Income from House Property		30,940

#### Notes:

1. Now the annual charge is not deductible
2. Under section 24, whether the tenant has undertaken to bear the cost of repairs or not, 30% of the annual value is deductible.
3. The annual value of self-occupied house is taken to be nil u/s 23(2) and no deduction is allowed u/s 24 except for interest. In the given case interest has been paid 12,000 but it is not deductible u/s 25 as neither the tax at source has been deducted nor there is any person in India who may be treated as his agent.

## Recap

- ◊ Computation of Taxable Income from House Property in the case of Let –Out House
- ◊ Computation of Taxable Income from House Property in the case of Self occupied House

## Objective Questions

1. Can there be loss from House Property ?
2. Can there be Negative Annual Value
3. What is the Gross Annual Value (GAV) if the house property is self-occupied?
4. Deduction under Section 24(a) is allowed at what rate?
5. How is Net Annual Value (NAV) calculated?

## Answers

1. Yes
2. Yes
3. Nil
4. 30 %
5. GAV – Municipal taxes paid by owner

## Assignments

1. The following are the details of Mr Vikram for the assessment year 2024-25: both houses are let out. Compute his income from house property for the assessment year 2024-25?(Values in rupees and are annual values)

Particulars	House Property 1	House Property 2
Municipal Value	4,20,000	3,50,000
Fair Rent	4,50,000	3,80,000
Standard Rent	4,00,000	3,60,000
Actual Rent	4,80,000	4,20,000
Unrealised rent for AY 2024-25(Conditions satisfied)	40,000	35,000
Vacancy (Conditions satisfied)	2 Months	2 Months
Municipal Taxes paid	12,000	17,500
Municipal Taxes due, but not paid	30,000	17,500
Repair expenses	60,000	90,000
Insurance Premium paid	12,000	9,000
Interest on loan for the construction of the house property		90,000

2. Compute taxable income from house property of Mrs.Sabana from the following particulars:

Fair market rent - ₹90,000

Actual Rent Received- ₹ 72,000

Municipal valuation - ₹70,000

Standard rent- ₹ 50,000

Municipal taxes- 20%

Interest paid - ₹18,000

3. Mr. Raghav owns a residential house which has two equal units. Unit one is self-occupied for his residential purpose and unit two is let out at Rs 30,000 pm. Two months' rent could not be collected. Municipal value of the house is Rs 6,50,000 p.a. Standard rent is Rs 6,25,000 p.a and fair rent is Rs 7,00,000 p.a. Municipal tax is paid at 10% of the municipal value. Interest on loan taken for the construction of the house during the year Rs 1,40,000. Compute the income from house property for the A Y 24-25.

4. Mr. Narain owns a property in Delhi. The details of the house are as follows. Municipal value Rs 1,64,000 p.a , fair rent Rs 2,16,000 p.a, standard rent Rs 1,80,000 p.a. The house is let out up to 31 January 2021 on a monthly rent of Rs 20,000. From February 1 onwards the property was used for his own residential purpose. Municipal tax paid for the current previous year is Rs 16,400, interest accrued during the year on the loan taken for the construction of the house was Rs 2,20,000. Compute the income from house property for the A Y 24 - 25.
5. Compute the income from house property of Mr.Sreerag from the following information:

Fair rent - ₹ 62,000

Let-out house - ₹ 7,000 per month

Standard rent - ₹ 65,000

Municipal tax paid @ 20% of Municipal Value:

Previous Year 2022-23 - ₹ 10,000

Previous Year 2023-24- ₹ 10,000

Other information are:

- (i) House remained vacant for two months during the previous year
- (ii) Unrealised rent allowed as a deduction in the Assessment Year 2022-23 but received during the Previous Year 2023-24 - ₹ 20,000
- (iii) Expenditure incurred on collecting unrealised rent - ₹ 5,000
- (iv) Arrears of rent received during the previous year - ₹ 10,000
6. Compute taxable income from house Mr. Alexander from the following particulars:

Fair market rent	- ₹ 90,000
Actual Rent Received	- ₹72,000
Municipal valuation	- ₹50,000
Standard rent	- ₹50,000
Municipal taxes	- 20%
Interest paid	- ₹15,000

7. Mr.Rohit is the owner of a house which is used as his residential house property. The details are as follows. Municipal value Rs 4,80,000 p.a, Fair Rent - Rs 5,40,000 p.a, Standard rent not applicable. Municipal tax paid Rs 24,000, Interest accrued during the year on the loan taken for the construction of the house Rs 2,80,000. The total interest paid during the

pre-construction period Rs 6,00,000. Find out: the income from house property for the A Y2024-25?

8. Ms. Indulekha is the owner of two houses, the details of the house properties for the A Y 24-25 are as follows:

Particulars	House Property 1	House Property 2
Municipal Value	40,000 per month	50,000 per month
Fair Rent	45,000 per month	60,000 per month
Standard Rent	42,000 per month	Not Available
Actual Rent	50,000 per month	Self-Occupied
Municipal taxes paid	24,000 p.a	15,000 p.a
Interest on loan for the assessment year 2020-21	2,90,000	2,20,000

Compute his income from both the house properties for the assessment year 2024-25?

## Reference

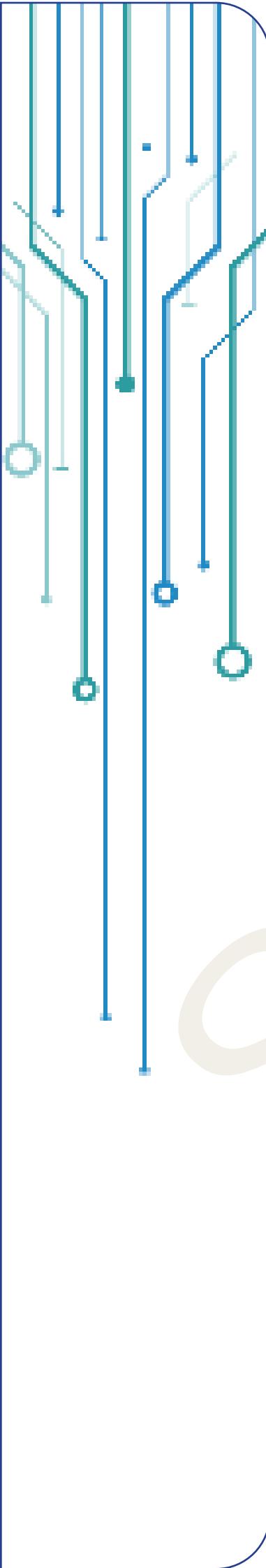
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BLOCK

Profit and Gains from  
Business and Profession



# Unit 1

## Profit and Gains from Business and Profession

### Learning Outcomes

After completing this unit, the learner will be able to;

- ◊ Comprehend the Concept of Business Income
- ◊ Analyze general deductions and determine their applicability in various business scenarios
- ◊ Evaluate Depreciation Rules
- ◊ Identify expenses that are expressly disallowed while computing business income.
- ◊ Apply the Concept of Actual Payment-Based Deductions

### Prerequisites

Imagine you are an entrepreneur starting your own business. You invest in furniture, buy high-quality machines, hire staff, and spend on advertising. As customers start coming in, you begin making revenue. But before you celebrate your profits, there's one crucial factor to consider taxation. Your business earns income, but not all revenue is considered profit for tax purposes. The government allows certain deductions, like rent, salaries, and electricity bills, but not personal expenses or penalties. Some costs, like machinery depreciation, are spread over time. And certain payments, like taxes and employee benefits, must be paid before claiming deductions. This unit will help you understand how profits and gains from business or profession are calculated under tax laws. You will learn what expenses can be deducted, which are disallowed, and how depreciation affects taxable income. By the end of this unit, you'll be able to analyze business income in a structured way ensuring compliance while optimizing tax benefits.

## Keywords

Business income, charge ability, deductions allowed, Depreciation, Disallowed deductions

## Discussion

Ramesh is a young man living in a small town. He decided to start a tea stall near the railway station to earn a living. Every day, he buys milk, sugar, tea leaves, paper cups, and gas for boiling water. These are his business expenses. He sells tea to travellers and earns money daily. The total amount he earns from selling tea is referred to as his business income or revenue. However, Ramesh doesn't get to keep all the money he collects! First, he must subtract the money he spent on milk, sugar, gas, and cups. The amount left after deducting these costs is his profit; this is the money Ramesh truly earns for himself. This profit from his tea business is called "Profits and Gains of Business or Profession" under the Income Tax Act. Ramesh will have to pay income tax on this profit because it is his income earned from carrying on a business. In paying tax under this head, he needs to understand the following terms.

### 5.1.1 BASIC TERMS

Any income by way of profit or gain from business or profession is taxable under sections 28 to 44 D of the Income Tax Act 1961. Before examining the various sections of the Income Tax Act related to income from business or profession, it is essential to understand the terms 'business' and 'profession'.

#### 5.1.1.1 Business Sec. 2(13)

Business refers to the purchase, sale, or manufacture of a commodity with the aim of making a profit. It encompasses any trade, commerce, or manufacturing activity, as well as any venture (Doing activity for the first time without knowing the outcome) or undertaking related to trade, commerce, and manufacturing.

To judge a transaction as a business transaction, the following points should be considered -

1. Nature of commodity
2. Nature of transaction (Whether incidental to a business or not)
3. Intention of the related party
4. Duration of transaction
5. Effort applied in the transaction.

#### 5.1.1.2 Profession Sec. 2(36)

Profession means the activities for earning a livelihood which require intellectual skill or manual skill, e.g. the work of a lawyer, doctor, auditor, engineer and so on, is in the nature of a profession. Profession includes vocation.

- ◊ **Vocation** : Vocation implies natural ability of a person to do some particular work e.g. singing, dancing, etc. Here, no training or no qualification is required but having natural ability.
- ◊ **Profits** : Excess income over expenditure.
- ◊ **Gains** : Any incidental revenue from business.

As the rules for the assessment of business, profession or vocation are the same, there is no importance of making any distinction between them for income tax purposes.

### 5.1.2 Basis of Charge (sec 28)

The following incomes are chargeable to income tax under the head profits or gains of business or profession.

- i. **Revenue Profits from Business or Profession** : The profits and gains of any business or profession which was carried on by the assessee at any time during the previous year.
- ii. **Any Compensation due to or received by an agent**: Any compensation or other payment due to or received by an agent, managing the whole or substantially the whole of the affairs of any person, at the termination of his management or modification of the terms and conditions relating thereto.
- iii. **Income of trade association, etc**: Income derived by a trade, professional or similar association from specific services performed for its members.
- iv. **Receipts in connection with foreign trade** :
  - a. Profit on sale of import license.
  - b. Duty Draw back / Duty remission (decrease) scheme / Duty free replenishment (refill) certificate.
  - c. Cash Assistance.
  - d. Profit on sale of Duty Entitlement Passbook.
  - e. Repayment of any customs or excise duty to any person against exports.
- v. **Value of any benefit or Perquisite from business or profession** : The value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession.
- vi. **Remuneration to partner from the firm** : Any interest, salary, bonus, commission or remuneration due to or received by a partner of a firm from the firm, provided that it has been allowed as a deduction in computing the taxable profits of such firm.
- vii. **Amount received or receivable for certain agreement** :
  - a. Not carrying out any activity in relation to any business or
  - b. Not sharing any know-how, patent, copyright, trade mark, license, franchise or any other business or commercial right of similar nature or information or

technique.

- viii. **Keyman Insurance Policy** : Any sum received under a keyman insurance policy including the sum allocated by way of bonus on such policy.
- ix. **Interest on securities**: Interest on securities, if the business of the assessee is to invest in securities, otherwise interest on securities shall be chargeable to income tax under the head income from other sources.
- x. **Recovery against certain capital assets covered u/s 35AD** : Any sum received on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as deduction u/s 35AD.
- xi. **Income from speculative transaction.**

Speculative transactions sec43(5) means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrip.

### 5.1.3 Computation of Income from Business or Profession (Sec. 29)

According to Section 29, the profits and gains of any business or profession are to be computed in accordance with the provisions contained in Sections 30 to 43D.

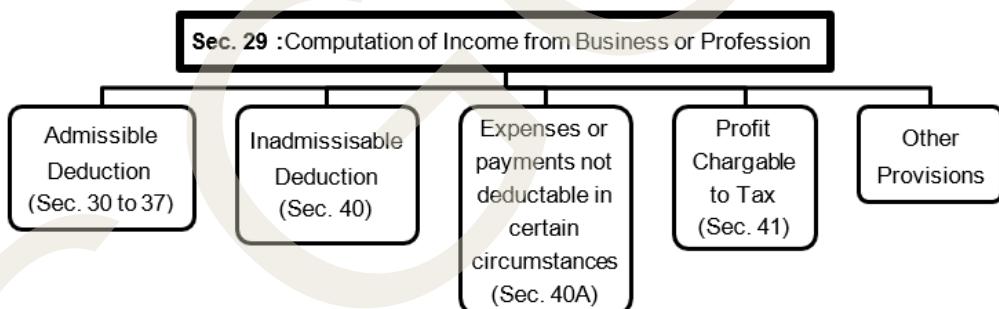


Figure 5.1.1 Computation of income from business or profession

#### 5.1.3.1 Rules for adjustment of Profit and Loss Account prepared by the Assessee

The profit and Loss Account prepared by the assessed is not correct from the income tax point, so need to adjust the profit and loss account according to the rules of income tax act.

- i. Several expenses are charged to it which are wholly or partly inadmissible.
- ii. Some admissible expenses are omitted.
- iii. Some taxable incomes are not credit
- iv. Some such incomes are credited which are either not taxable under the head

PGBP or are not taxable at all.

**Table 5.1.1 Proforma for computation of Income under the head PGBP**

	Particulars	Rs.	Rs.
	Profit as per P & L A/c		xxx
Add :	i) Expenses or losses disallowed but charged in P & L A/c	xxx	
	ii) Incomes taxable as business income but not credited to the P & L A/c	xxx	
	iii) Expenses in excess of the allowed amount charged to P & L A/c	xxx	
	iv) Under valuation of closing stock or over valuation of opening stock	xxx	xxx
Deduct	i) Expenses or losses allowed but not debited to P & L A/c	xxx	
	ii) Incomes not taxable as business income but credited to the P & L A/c	xxx	
	iii) Income exempt from tax but credited in P & L A/c	xxx	
	iv) Over valuation of closing stock and under valuation of opening stock	xxx	xxx
	<b>Taxable income from Business</b>		<b>xxx</b>

### 5.1.3.2 Deductions Expressly Allowed (Sec. 30 to 37)

According to the Income Tax Act, while calculating his taxable business income, business is allowed to deduct these necessary business expenses like rent, repairs, interest on the loan, and cost of materials—from his total earnings. These types of deductions are clearly listed and allowed under Sections 30 to 37, which help reduce taxable profit by allowing all genuine and essential business costs.

**1. Expenses in respect of business premises(Sec. 30):** Revenue expenses for the use of premises for business or profession are allowed.

- Premises are occupied as a tenant: Rent, Repair, Insurance and Tax.
- Premises are occupied as owner: Repair, Insurance and Tax.

**Note :**

- If the business premise belongs to the assessee no deduction in respect of rent will be allowed.
- If the assessee is a partnership firm and the business premises belong to a partner of the firm, the rent payable to the partner will be an allowable deduction.

**2. Revenue Expenditure on Plant and Machinery / Furniture and Fixtures (Sec. 31):** Revenue expenditure incurred on current repairs and insurance premiums incurred on plant and machinery/furniture and fixtures is allowed. [Rent and taxes are allowed u/s 37]

**Note:** Capital expenditure shall not be included in repairs.

### 3. Depreciation(sec 32)

When a business purchases items such as machinery, computers, or vehicles to conduct its operations, these assets eventually become old, worn out, or lose value over time. This gradual decline in value is referred to as depreciation. For instance, if Ravi buys a bakery oven for ₹1,00,000, its value will not remain the same after one year; it diminishes due to usage. The Income Tax Act permits businesses to deduct this loss in value from their income as an expense. This facilitates an accurate representation of the company's profit, as the cost of utilising these assets is also a component of operating the business. Thus, depreciation (under Sec 32) is a legal deduction for the reduction in the value of fixed assets, permitted annually at prescribed rates, to ascertain the correct business profit.

**Table 5.1.2 Difference between Depreciation under Accounting Rules and Taxation Rules**

No.	Accounting System	Taxation System
1.	Charges against profit.	Allowances in nature
2.	WDV / SLM method is allowed.	Only WDV method is allowed. (Electricity Generation Unit can adopt the SLM Method)
3.	Depreciation is charged on Individual Asset	Depreciation is charged on Block of asset.
4.	On the basis of number of days asset used.	50% of normal Depreciation (If asset is used below 180 days) or Normal Depreciation.
5.	Only on Tangible Asset.	Tangible and Intangible asset.
6.	Life of the asset.	Prescribed rate.
Note; WDV= written down value method and SLM – straight line method		

#### i. Category of Asset : Five categories of assets.

- Building
- Furniture and Fittings.
- Machinery and Plant
- Ships
- Intangible Asset (Know-how, Patents, Copyrights, Trademarks, Licenses, Franchises or Commercial rights).

#### ii. Block of Assets

- Falls under the same category.
- On which same rate of depreciation is applied.

#### iii. Conditions of Allowance of Depreciation

There are two essential conditions :

- Asset should be owned, wholly or partly by the assessee.

b. It should be used for business

#### iv. 50% of normal Depreciation

If any asset is acquired and put to use not to exceed 180 days during the same previous year, then the assessee can get the benefit of depreciation of only 50% of the normal depreciation.

**Table 5.1.3 Format for computation of Depreciation**

	Opening WDV of block	xxx
Add	Actual Cost of asset acquired during P.Y.	xxx
Less	Money payable in respect of asset sold / discarded / damaged, etc.	xxx
	WDV for Depreciation	xxx
Less	Depreciation at the prescribed rate	xxx
	Closing WDV	xxx

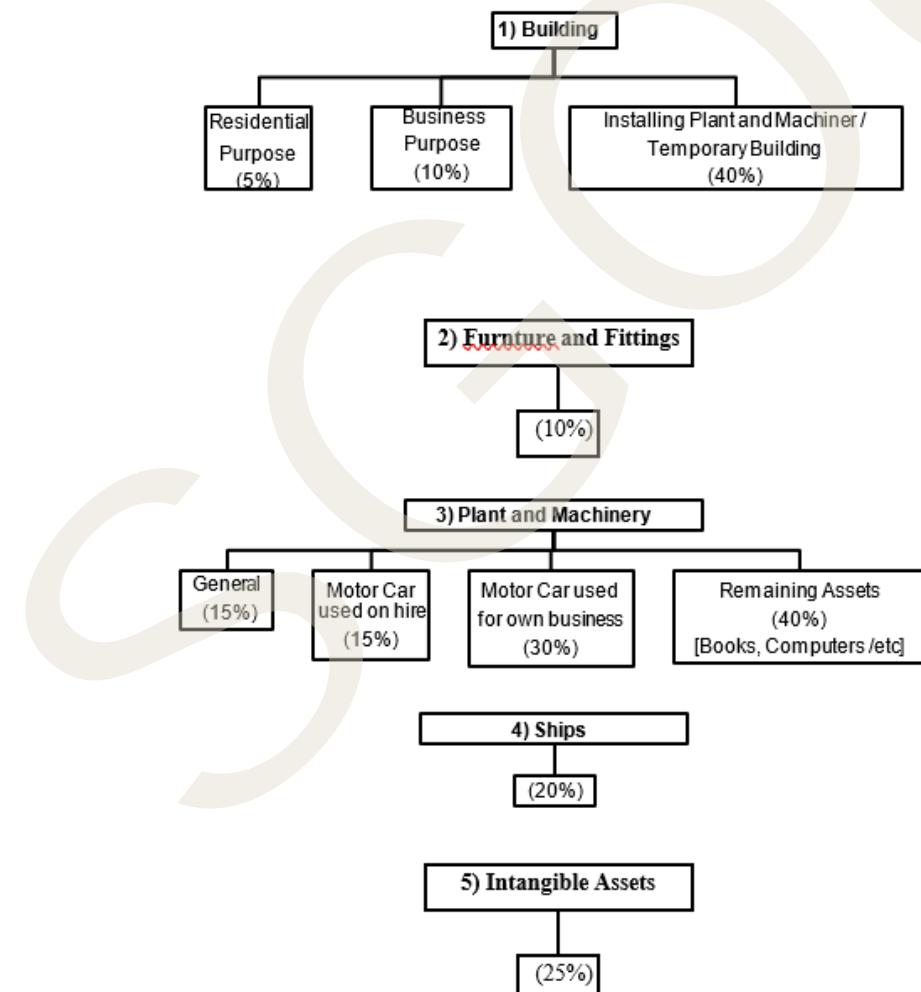


Figure 5.1.2 Rates of depreciation prescribed under Income Tax Act

#### **4. Tea, Coffee and Rubber Development Account(Sec. 33AB)**

- a. The assessee should deposit in a special account with the National Bank for Agricultural and Rural Development.
- b. The deposit should be made within six months from the end of the PY or before furnishing the return of his income, whichever is earlier.
- c. Limit: Sum equal to deposited or 40% of profits of such business (before making deduction under this section and before setting off brought forward business losses), whichever is less.
- d. Utilization of funds : Must be used in the same previous year in which it is withdrawn.

#### **5. Site Restoration Fund (Sec 33ABA)**

Deduction will be allowed in respect of prospecting, extraction or production of petroleum or natural gas in India. It is necessary that, agreement with central government.

- a. The assessee should deposit in a special account with the State Bank of India.
- b. The deposit should be made before the end of the previous year.
- c. Limit: Sum equal to deposited or 20% of profits of such business (before making deduction under this section and before setting off brought forward business losses), whichever is less.

#### **6. General Deduction (Sec. 37 ) (Residuary section)**

Sometimes a business spends money on things that are not covered under specific sections like rent, repairs, or depreciation but are still necessary for running the business, Such as advertising, travelling for business work, or office stationery. These are called general business expenses.

Conditions should be fulfilled –

- a. Expenses not covered under sections 30 to 36.
- b. Revenue nature expenditure.
- c. Not of capital nature
- d. Not of personal nature
- e. Expenses incurred for running of business / profession.
- f. Expenditure shall be made during the previous year.

Explanation 1 : Expenditure incurred on protection money, hafta, bribes, etc. will not be allowed.

Explanation 2 : Expenditure incurred on CSR (Corporate Social Responsibility) activities will not be allowed.

Examples of expenses allowed :

1. Expenses incurred in the purchase, manufacture and sale of goods.
2. Expenses incurred on the day-to-day running of the business.

3. Expenses incurred on breach of contract.
4. Amount of Value Added Tax / GST, excise duty, and professional tax.
5. Compensation paid for the retrenchment of an undesirable employee.
6. Contribution made to the provident fund.
7. Commission paid for securing orders.
8. Compensation paid to employees due to an accident on duty.
9. Royalties paid for mines.
10. Insurance premium paid for the policy of its employees for compensation during work.
11. Compulsory subscription to an association.
12. Legal expenses for the normal course of business, to avoid business liability, defend the title of his assets, terminate a disadvantageous trading relationship, and resist a winding-up petition by some shareholders.
13. Annual listing fee paid to the stock exchange.
14. Expenditure on the inauguration ceremony.

**(Sec 34:** Conditions for depreciation allowance and development rebate [Omitted w.e.f. **1.4.1988**]).

## 7. Expenditure on Scientific Research(Section 35 )

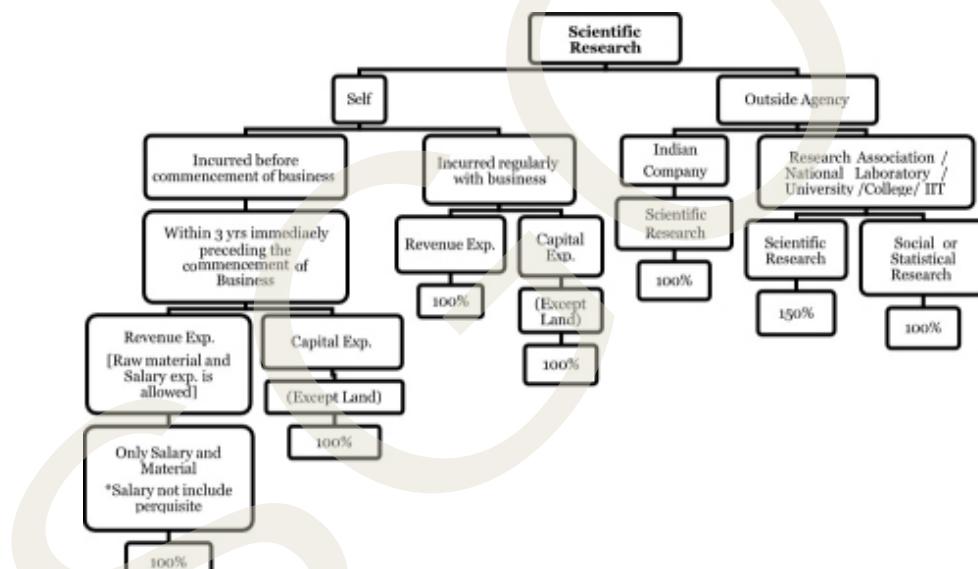
Sometimes, a business spends money on scientific research to develop new products, improve technology, or find better ways of doing things. Such spending helps the business grow and also benefits the industry. For example, suppose a medicine company spends money on testing a new drug in its own laboratory or gives money to a recognised research institute. In that case, this is called scientific research expenditure. Under Section 35, the government allows these expenses to be fully or partly deducted from the business income. This reduces the taxable profit and encourages businesses to invest more in research and development (R&D).

**Scientific Research:** It means activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries.

**Scientific Research Expenditure:** It means expenditure incurred on scientific research would include all expenditure incurred for the prosecution or the provision of facilities for the prosecution of scientific research but does not include any expenditure incurred in the acquisition of right in or arising out of scientific research.

**Table5.1.4 A summary of weighted deduction u/s 35**

Section	Expenditure incurred / contribution made	Deduction (As a % of contribution made)
35(1)(i)	Revenue Exp. Incurred on scientific research related to the assessee's business	100%
35(1)(ii)	Research Association for scientific research	150%
35(1)(iia)	Company for scientific research	100%
35(1)(iii)	Research Association for research in social science or statistical Research	100%
35(1)(iv)	Capital expenditure (Other than expenditure on land)	100%
35(2AB)	Expenditure on in-house research (Except land and building)	150%



**Figure 5.1.3 Scientific research**

**In-house Research :** A deduction of an amount equal to 150% of expenditure (excluding land or building) shall be allowed.

## 8. Amortisation of Preliminary Expenses (Section 35D)

When a new business starts or an existing one expands, some initial expenses are made before the actual business activities begin like preparing project reports, market surveys, legal fees for company registration, etc. These are called preliminary expenses.

Preliminary expenses include –

1. Preparation of feasibility report,
2. Preparation of project report
3. Conducting a market survey.
4. Legal charges for drafting any agreement.
5. Printing charges for the Memorandum and Articles of Association.
6. Fees paid for registering the company.
7. Expenses regarding issue of shares or debentures e.g. underwriting commission, brokerage, typing, printing, advertisement of prospectus etc.

**Deduction :** Deduction is allowed is 1/5 of such expenditure for each of the five successive previous years beginning with the previous year in which the business commences.

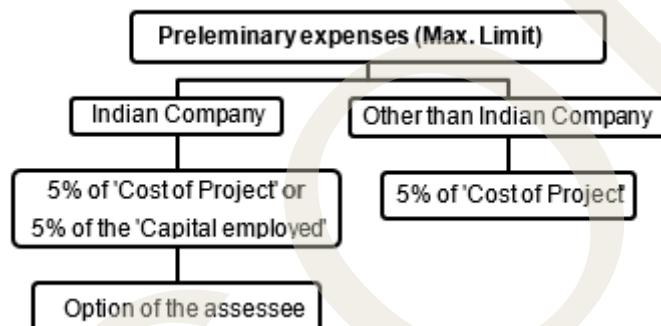


Figure 5.1.4 preliminary expenses

#### 9. Expenditure for amalgamation or demerger of an undertaking(Sec. 35DD )

Allowed deduction of 20% of such expenditure for each of the five successive previous years beginning with the year in which amalgamation or demerger takes place.

#### 10. Expenditure on voluntary retirement(Section 35DDA )

Allowed deduction of 20% of such expenditure for each of the five successive previous years beginning with the year in which the expenditure was incurred.

#### 11. Expenditure on Specified Business (Sec. 35 AD)

100% expenditure of capital nature is allowed [Excluding land, goodwill, financial instrument]

Deduction is allowed in the year in which business is commenced –

- a. Expenditure incurred prior to commencement of its operations.
- b. The amount is capitalised in the books of accounts on the date of commencement of its operations.

Payment of Rs. 10,000 in a day should not be made in cash.

## Specified Businesses

1. Setting up and operating of cold chain facility.

Cold chain facility means a chain of facilities for storage or transportation of:

- a. Agriculture and forest produce,
- b. Meat and meat products,
- c. Poultry
- d. Marine and dairy products
- e. Products of horticulture, floriculture and apiculture
- f. Processed food items.

2. Warehousing facility – for storage of agricultural produce.

3. Laying and operating of petroleum oil pipeline.

4. At least one hundred beds hospital.

5. Building for slum redevelopment or rehabilitation framed by Central or State Government.

6. Housing project under a scheme for affordable housing framed by Central or State Government.

7. Two-star or above category hotel.

8. Production of fertilizer in India.

9. Inland container depot / container freight station.

10. Bee-keeping and production of honey and beeswax.

11. Warehousing facility for storage of sugar.

12. Infrastructure facilities: toll road, bridge, water supply, water treatment, irrigation project, sanitation, port, airport, etc.

13. Semiconductor wafer fabrication manufacturing unit.

## 12. Other deduction(sec:36) :

- 1. Insurance premium paid for stock which is used for purpose of business / profession.
- 2. Insurance premium for cattle, paid by the federal milk co-operative society.
- 3. Insurance premium paid (any mode other than cash) for the health of employees.
- 4. Bonus or commission to employee. (On actual payment basis)
- 5. Interest paid on borrowed capital for the purpose of business / profession (On actual payment basis).
- 6. Discount on Zero Coupon Bond allowed as deduction on pro-rata basis.

Bad debts – The debt should be incidental to the business.

8. Loss regarding animals (Not for stock in trade) – allowed as deduction. [Cost of animal – carcasses of animals]
9. Employer's contribution to the Provident Fund is only recognised for a Provident Fund or an approved superannuation fund. [Subject to Sec. 43B]
10. Employees contribution to provident fund or superannuation fund etc. [Subject to Sec. 43B].
11. Approved gratuity fund. [Subject to Sec. 43B].
12. Expenditure on family planning (Only when assessee is company) : Capital expenditure as 5 equal installments; Revenue expenditure as in the same previous year.
13. Entertainment expenses, advertisement expenses (Except section 37(2B) i.e. advertisement in political party).
14. Security Transaction Tax (STT).

#### **5.1.3.3 Expenses not allowed in any circumstances (Sec. 40(a))**

1. Expenditure on advertisement in any souvenir, etc., published by a political party.
2. Payments outside India, in India to a non-resident or a foreign company on which TDS is not deducted and has not been paid on or before the due date specified.
3. Payment to residents – on which TDS has not been deducted or before the due date of filing the return of income, 30% of such sum shall not be allowed as a deduction.
4. Wealth tax : Wealth tax chargeable under the Wealth Tax Act shall not be allowed as a deduction.
5. Tax on Profits and Gains : Any sum paid on account of any tax levied on the profits and gains of any business or profession shall not be allowed as a deduction.
6. Contribution to unrecognized provident fund.

#### **5.1.3.4 Expenses not deductible in certain circumstances (Sec. 40A)**

1. Excessive payment to relatives.
2. Payment in Cash: Payment made to a person on the same day is made exceeding Rs. 10,000 other than an account payee cheque, bank draft or use of the electronic clearing system, it will be disallowed. The entire amount will be disallowed.
3. Exception: Where payment is made for plying, hiring or leasing goods carriages, the limit of disallowance shall be exceeding Rs. 35,000.

#### **5.1.3.5 Deductions are allowable only on actual payments. (43B) :**

1. Any sum payable by the assessee by way of tax, duty, cess or fee.
2. Any sum payable by him as an employer by way of contribution to any provident fund, superannuation fund or gratuity fund or any other fund for the

welfare of employees.

### 5.1.3.6 Certain Allowable Losses

Losses which are directly incidental to the business or profession of the assessee are allowable.

Following are some examples of such losses.

1. **Robbery or Dacoity :** Loss caused by robbery or dacoity is not deductible. But, if it is incidental to business it will be allowed as a deduction and this depends upon the specific circumstances and conditions. For example, if cash is sent for disbursement at different centers by a sugar factory in rural area, it is incidental to business and is, therefore, allowed. Any loss due to robbery in a bank will be allowed as the bank is under an obligation to maintain some cash outside the strong room for payments.
2. **Embezzlement (Misappropriation), Theft, etc. :** The loss of money due to embezzlement by an employee handling the funds of the business while discharging his official duties is allowed as deduction. When an employee goes to the bank to deposit the cash and he takes away the money for his own use, even then, the loss is allowable. Theft by a cashier, who is in charge of cash, is also an allowable loss. A theft committed either by an employee or by someone else by breaking into the business premises after office hours is also allowable.
3. **Loss due to Non-recovery of Advances :** If it is the practice in a business to give advance money to the suppliers and if the supplier neither supplies the order nor refunds the advance money, the loss sustained by the assessee is incidental to business and is, therefore, allowable.

**Note:** Penalty paid for **infraction of law** is not allowed: If a business pays a fine or penalty for breaking the law, such as a traffic fine, pollution control penalty, or GST late fee, this expense cannot be claimed as a deduction from business income. This is because the law does not allow benefits for unlawful actions. Only genuine business expenses are allowed; any cost related to the violation of rules or laws is not deductible while calculating taxable profit. In short, penalties for breaking the law are not allowed as business expenses under the Income Tax Act.



## Recap

- ◊ Income earned from running a business or profession is taxable under this head after allowing permitted deductions.
- ◊ Tax is charged on the net profit of the business or profession after reducing allowable expenses from total income.
- ◊ Certain specific expenses like rent, repairs, insurance, and interest are clearly allowed as deductions under Sections 30 to 37.
- ◊ All necessary business expenses not covered under specific sections, like advertising or office expenses, are allowed under Section 37.
- ◊ A part of the cost of fixed assets like machinery or vehicles is deducted every year to account for their normal wear and tear. Fines, penalties, and expenses for breaking the law are not allowed as deductions while calculating business income.
- ◊ Some expenses, like tax or contributions to employee welfare funds, are allowed as deductions only when they are actually paid.

## Objective Questions

1. In which economic activity are the employee's intellectual skills used?
2. What is the amount of deduction available to an assessee on account of deposit made in the coffee development account?
3. How much of revenue expenditure on scientific research can be claimed as a deduction?
4. How much of the expenditure on in-house research and development can be claimed?
5. For which assets can the straight-line method of depreciation be used?
6. When is the depreciation claimed as a deduction at half of the annual charge?
7. What is the rate of additional depreciation claimable?
8. Under what section are the deductions on an actual payment basis discussed?

## Answers

1. Profession
2. 40% or the actual amount whichever is less
3. Full amount
4. 100%
5. Assets used in the generation and distribution of power
6. Assets used for less than 180 days during the PY
7. 20%
8. 43B

## Assignments

1. Enumerate expenses which are allowed in computing taxable profits of a business and also state expenses or losses which are not admissible.
2. In what circumstances are the following items allowed as deductions in computing income from business: (i) Repairs, (ii) Insurance Premium, (iii) Interest, (iv) Legal Charges?
3. Explain clearly the deductions that are expressly allowed in computing the income from business under the Indian Income Tax Act, 1961.
4. In computing income from business what are the provisions relating to the following expenses:
  - a. Expenses on Scientific Research;
  - b. Deduction in respect of Preliminary Expenses;
  - c. Bad debts.
5. MNP Ltd. commenced operations of the business of a new four-star hotel in Chennai on 1.4.2023. The company incurred capital expenditure of ₹ 40 lakh during the period January 2023 to March 2023 exclusively for the above business and capitalised the same in its books of account as of 1st April 2023. Further, during the Previous Year 2023-24, it incurred capital expenditure of ₹ 250 lakh (out of which ₹ 100 lakh was for the acquisition of land exclusively for the above business). Compute the income under the heading "Profits and Gains of Business or Profession" for the Assessment Year 2024-25, assuming that MNP Ltd. has fulfilled all the conditions specified for the claim of deduction under section 35AD and has not

claimed any deduction under Chapter. Deduction to be made from gross total income while computing total income. The profits from the business of running this hotel (before claiming deduction under section 35AD) for the Assessment Year 2024-25 is ₹ 80 lakh. Assume that the company also has another existing business of running a four-star hotel in Kanpur, which commenced operations 6 years back, the profits from which were ₹ 130 lakh for the Assessment Year 2024-25.(Answer = Income from business or profession = 20 lakh)

6. 'X' Ltd. is engaged in providing telecommunication services in India. For this purpose, it enters into an agreement on 1.4.2022 with the Department of Telecommunication, Government of India. As per agreement, 'X' Ltd. is given a licence for providing telecommunication services in M.P. State for a period of 10 years from 1.4.2022. License fees are fixed at 18 lakh payable in two equal instalments on 10.4.2022 and 10.4.2023. Assuming that the two instalments are paid by X' Ltd. on due dates, compute the admissible deduction u/s 35ABB for the Previous Year 2023-24. Business commenced during the Previous Year 2022-23.( Answer = deductions allowable =190000)
7. Compute total income of the firm from the following particulars :Net loss ₹ 80,000 after charging interest on capital and loan to partners but before salary and commission to partners.
  - a. (Interest on capital to Rajan 25,000 on the capital of ₹ 1,00,000 and interest on loan to him 10,000 on a loan of ₹ 40,000. His remuneration was ₹ 6,000 per year.
  - b. Interest on capital to Sanjiv was 18,000 on capital of 80,000 and interest on loan was ₹ 12,000 on a loan of ₹ 70,000. The loan was taken by the firm on 1.6.2023. No remuneration was payable to him.

( Answer = Netloss c/f=54400)

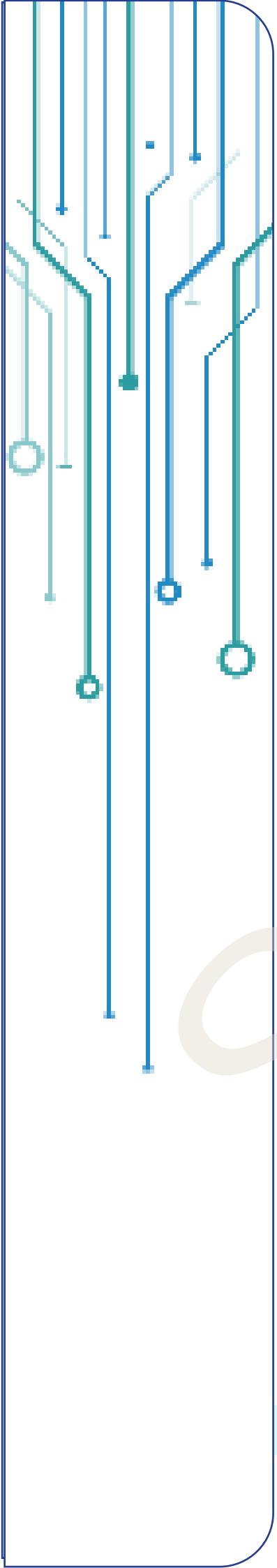
8. What deductions are allowed to a businessman in computing profits? Specify the expenses disallowed.
9. What are the allowances that are admissible in determining the income from a business?

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# Unit 2

## Computation of profits and gains of business and profession

### Learning Outcomes

After completing this unit, the learner will be able to;

- ◊ recognizing allowed and disallowed expenses for the computation of taxable business and professional income
- ◊ gain knowledge about the concept of taxable business income
- ◊ practice to the computation of taxable business and professional income

### Prerequisites

Imagine you are an entrepreneur running a small business or a professional managing your practice. At the end of the financial year, you are required to compute your taxable income. However, not all expenses you incur can be deducted from your earnings some are permitted, while others are disallowed by tax laws. Understanding these distinctions is crucial for accurate tax compliance and financial planning.

This unit will guide you through the essential concepts of taxable business and professional income. You will learn to identify which expenses are deductible under tax regulations and which are not. Additionally, you will gain hands-on experience in computing taxable income, ensuring that you can apply theoretical knowledge to real-world scenarios. By the end of this learning journey, you will not only be familiar with tax provisions but also be equipped to perform computations effectively, a skill that is valuable for entrepreneurs, accountants, and finance professionals alike.

## Keywords

Taxable business income, Disallowed expenses, Allowable deductions, depreciation

## Discussion

When you run a business or practise a profession, you are required to pay tax on the profit you earn. However, the profit calculated for tax purposes may not be the same as the profit shown in your books of accounts. To arrive at taxable business income, you need to follow a simple method. First, take the net profit from the Profit and Loss Account. Then, add back any expenses that are not allowed under tax laws, such as personal expenses, penalties, or income tax paid. After that, reduce any income that is not related to the business, like capital gains or interest earned from other sources. Finally, deduct the allowances permitted under the tax law, such as depreciation and scientific research expenses. For example, if a trader shows a net profit of ₹5,00,000, has disallowed expenses of ₹30,000, non-business income of ₹15,000, and allowable deductions like depreciation of ₹30,000, the taxable business income would be ₹4,85,000 (500000+30000-15000-30000).

### 5.2.1 Methods of Accounting (Computation)

The financial statements of a business are prepared according to accounting standards and principles. The amount of profit as shown by such financial statements may not be admitted by the assessing officer of income tax. He will accept only the profit or income derived as according to the income tax provisions. Hence, the person has to make adjustments in the financial statements of the business to accommodate the income tax provisions for filing the income tax return. There are mainly two methods for preparing financial statements according to the Income tax Act.

**Method 1:** The following rules are considered while drawing profit and loss account:

1. Those expenses or losses which are charged to the Profit and Loss Account but are not allowed under the Income Tax Act, should be added to the profit shown by the Profit and Loss Account prepared by the assessee.
2. If any expense is partly disallowed, only the disallowed part of it shall be added to the profit.
3. If any admissible expenses are omitted from the Profit and Loss Account, they should be deducted from the above profit.
4. If some taxable incomes are omitted from the Profit and Loss Account they should be added to the above profit.
5. If some such incomes have been credited to the Profit and Loss Account which

are either not taxable under the head 'Business or Profession' or are not taxable at all, they should be deducted from the above profits.

Note: If instead of profit there is a loss as per the Profit and Loss Account, the above rules shall be reversed, i.e., items to be added shall be deducted and those to be deducted shall be added. If after making some adjustments the profit is converted into loss, the above rules shall be reversed for subsequent adjustments.

The above rules can well be illustrated with the help of the following:

**Table 5.2.1 Format for Computation of Taxable Profit under Method I**

Profit as per P & L A/e			xxx
Add:			
i	Expenses or losses disallowed but charged in P. & L. Ale	xxx	
ii	Incomes taxable as business income but not credited to the P & L. A/C	xxx	
iii	Expenses in excess of the allowed amount charged in P. & L A/C	xxx	
iv	Under-valuation of closing stock or over-valuation of opening stock	xxx	
Deduct:			xxx
i	Expenses or losses allowed but not debited to P. & L. A/c	xxx	
ii	Incomes not taxable as business income but credited to the P. & L. A/c	xxx	
iii	Incomes exempt from tax but credited in P. & L. A/c	xxx	
iv	Over-valuation of closing stock and under-valuation of opening stock.	xxx	
Taxable Income from Business			xxx
			xxx

Note:

1. For loss as per P. & L. A/e the above rules will be reversed.
2. The same rules will apply to Income and Expenditure Account.
3. In the case of Receipts and Payments Account or Cash Book, the following statement is prepared to find out profit and gains from profession:

Incomes from Profession		Xxx
Less: All admissible expenses relating to the profession		Xxx
Income from Profession Taxable		XXX

**Method 2:** Second Method of Computing the Taxable Profits or Losses of Business or Profession. In this method a fresh Profit and Loss Account or Income and Expenditure Account is prepared to determine the profit or loss. The format of this method may be as under:

Table 5.2.2 Format for Method 2

Add together all taxable incomes under this head which relate to the previous year concerned		xxx
Deduct all admissible expenses under this head which relate to the previous year concerned	(xxx)	(xxx)
Deduct admissible business losses	(xxx)	(xxx)
Taxable Profits or Losses of Business or Profession		xxx

**(Note:** The second method is generally used in case of professions.)

### 5.2.2 Practical problems

For getting experience on computation of taxable business income following illustration will help you.

#### Illustration 5.2.1

Mr. Amitabh prepared the following profit and loss account of his cloth shop for the year ended 31<sup>st</sup> March, 2024. Find out his income from business for the AY 2024-25.

#### Profit and Loss Account (For the year ended 31<sup>st</sup> March, 2024)

Particulars	Rs.	Particulars	Rs.
Salaries and wages	33,000	Gross Profit	3,34,725
Rent, etc.	1,600	Gifts received from relatives	275
Household expenses	82,000		
Income Tax	900		
Advertisement	800		
Postage expenses	600		
Gifts to relatives	900		
Fire Insurance Premium	400		
Life Insurance Premium	2,100		
Bad Debts Reserve	800		
Audit Fees	400		
Net profit	2,11,500		
Total	3,35,000	Total	3,35,000

**Solution :****Computation of Income from PGBP**

A.Y. : 2024-25

	<b>Particulars</b>	<b>Rs.</b>	<b>Rs.</b>
	Profit as per P & L A/c		2,11,500
Add :	Household expenses	82,000	
	Income Tax	900	
	Gifts to relatives	900	
	Life Insurance Premium	2,100	
	Bad Debts Reserve	800	86,700
			2,98,200
Less	Gifts received from relatives	275	275
	<b>Taxable income from Business</b>		<b>2,97,925</b>

**Illustration 5.2.2**

Given below is the Profit and Loss Account of a Timber Merchant for the year ended 31<sup>st</sup> March, 2024. Compute total income for the AY 2024-25.

**Profit and Loss Account (For the year ended 31<sup>st</sup> March, 2024)**

<b>Particulars</b>	<b>Rs</b>	<b>Particulars</b>	<b>Rs</b>
Opening Stock	25,000	Sales	6,00,000
Purchases	2,50,000	Rent for Property	15,000
Wages	1,00,000	Closing Stock	35,000
Audit Fees	1,000		
Repairs (House Property)	2,000		
General Charges	1,500		
Commission for raising loan	1,000		
Bad debts Reserve	500		
Bad debts	2,000		
Interest on capital	10,500		
Contribution to Staff Welfare Fund	2,500		
Provision for Income Tax	1,500		
Depreciation (Allowable)	2,500		
Net Profit	2,50,000		
<b>Total</b>	<b>6,50,000</b>	<b>Total</b>	<b>6,50,000</b>

**Computation of Income from PGBP**  
A.Y. : 2024-25

	<b>Particulars</b>	<b>Rs.</b>	<b>Rs.</b>
	Profit as per P & L A/c		2,11,500
Add :	Household expenses	82,000	
	Income Tax	900	
	Gifts to relatives	900	
	Life Insurance Premium	2,100	
	Bad Debts Reserve	800	86,700
			2,98,200
Less	Gifts received from relatives	275	275
	<b>Taxable income from Business</b>		<b>2,97,925</b>

**Illustration 5.2.3**

Given below is the Profit and Loss Account of a Timber Merchant for the year ended 31<sup>st</sup> March, 2024. Compute total income for the AY 2024-25.

**Profit and Loss Account (For the year ended 31<sup>st</sup> March, 2024)**

<b>Particulars</b>	<b>Rs</b>	<b>Particulars</b>	<b>Rs</b>
Opening Stock	25,000	Sales	6,00,000
Purchases	2,50,000	Rent for Property	15,000
Wages	1,00,000	Closing Stock	35,000
Audit Fees	1,000		
Repairs (House Property)	2,000		
General Charges	1,500		
Commission for raising loan	1,000		
Bad debts Reserve	500		
Bad debts	2,000		
Interest on capital	10,500		
Contribution to Staff Welfare Fund	2,500		
Provision for Income Tax	1,500		
Depreciation (Allowable)	2,500		
Net Profit	2,50,000		
<b>Total</b>	<b>6,50,000</b>	<b>Total</b>	<b>6,50,000</b>



**Solution :**

**Computation of Income from Business**

	<b>Particulars</b>	<b>Rs.</b>	<b>Rs.</b>
	Profit as per P & L A/c		2,50,000
Add :	Repairs (House Property)	2,000	
	Bad debts Reserve	500	
	Interest on capital	10,500	
	Contribution to Staff Welfare Fund	2,500	
	Provision for Income Tax	1,500	17,000
			2,67,000
Less	Rent for Property		15,000
	<b>Taxable income from Business</b>		<b>2,52,000</b>

**Illustration 5.2.3**

A banking company has prepared the following profits and loss account for the year ended 31 March 2024.

To interest paid	200000	By interest on overdraft	60000
Salaries allowances	150000	Interest in cash credit	100000
Rent and taxes	20000	Interest on loans	300000
Postage charges	10000	Interest on securities	120000
Printing	8000	Commission	40000
Depreciation	40000	Rent of buildings( mortgaged with the bank)	60000
Other expenses	20000	Underwriting commission	30000
Provision for income tax	230000	Profit on sale of shares underwritten	70000
Provision for bad debts	40000		
Profit to balance sheet	62000		
	780000		780000

Compute the income of the banking company for the relevant assessment year

**Solution :**

Net profit	62000
Add ;	
Disallowed items:	
i. Provision for income tax	230000
ii. Excess bad debt provision	11780
Total of disallowed items	241780
<b>Business income</b>	<b>303780</b>

**Notes:**

1. Assessee's business is to invest in securities, hence, interest on securities is assessable under the head Profits and Gains of Business or Profession.
2. The Assessee is not the owner of the buildings and mortgaging of property is the business of the assessee, hence, rental income is assessable under the head 'Profits and Gains of Business or Profession'. Excess bad debts provision has been calculated as under:
3. Bad debts provision allowed 8.5% of  $(₹62,000 + ₹2,30,000 + ₹40,000) = 8.5\% \text{ of } ₹3,32,000 = ₹28,220$ . Excess =  $₹40,000 - ₹28,220 = ₹11,780$ .

**Illustration 5.2.4**

Dr. Dhruvin is a renowned medical practitioner who maintains books of account on a cash basis. furnishes his Receipts and Payments Account for the Financial Year 2023-24:

Balance b/d	14000	Rent of clinic :	
Consultation fees:		2022-23	600
2022-23	3000	2023-24	4800
2023-24	15000	2024-25	600
2024-25	2000	Electricity and water bills	2000
Visiting fees	30000	Purchase on professional books	4000
Loan from bank for professional purposes	25000	House hold expenses	7800
Sale of medicines	60000	Collection charges and dividend income	100
Gifts and presents	5000	Motor car purchased	30000
Remuneration from articles published in professional journals	6000	Surgical equipments	4800
Dividend	10000	Income tax	10000
Interest on post office savings	7000	Salary to staff	15000
		Life insurance premium	15000
		Gift to wife	5000
		Interst on loan	2000
		Car expenses	15000
		Purchase of medicine	40000
		Balance c/d	20300
	<hr/>	<hr/>	<hr/>
	177000		177000

Compute his taxable professional income for the Assessment Year 2024-25, after taking into account the following additional information:

- i. 1/3 of the use of motor-car relates to his personal use.
- ii. Depreciation on motor-car allowable is 15%, on books it is @ 40% and on surgical equipment, it is @ 15%
- iii. Gifts and presents include 3,000 from patients in appreciation of his medical service and 2,000 received as birthday gifts from relatives.
- iv. Closing stock of medicines amounted to ₹ 5,500.

**Solution:**

**Computation of Taxable Professional Income of Dr.Dhruvin**  
**(For the assessment year 2024-2025)**

Gross professional earnings:

Consultation fees	20000
(3000+15000+2000)	30000
Visiting fees	60000
Sale of medicines	3000
Gifts from patients	6000
Remuneration from article published	119000

Less:

Expenses allowed:

Rent of clinic(600+4800+600)	6000
Electricity and water bills	2000
Depreciation on books@40 %	1600
Depreciation on surgical equipments@15%	720
Salary to staff	15000
Interest on loan	2000
Car expenses(2/3 for professional purpose)	10000
Cost of medicines	40000
Depreciation on car@15 %	3000
(2/3 for professional purpose)	
Less-	
	Total of expenses allowed
	<b>Taxable professional income</b>

## Notes

1. Since the assessee maintains his books of account on cash basis, the actual receipts and payments have been treated as incomes and expenditures irrespective of the years to which they relate.
2. Remuneration from articles published in professional journals is professional income.
3. Birthday gifts from relatives are not taxable.
4. Dividend is not a professional income.

## Illustration 5.2.5

State, giving brief reasons, whether the following items are allowable while computing profits and gains of business or profession:

- i. Donation to a political party.
- ii. Fees paid to the lawyer for drafting a new Partnership Deed.
- iii. Sums paid to a labour leader to call off the strike.
- iv. Salary paid to son, who is working in the office. The salary is reasonable.
- v. Rent paid to daughter for office block which was gifted to her at the time of her marriage.
- vi. Bonus to partner for extra services.
- vii. Interest paid to wife on money borrowed from her.
- viii. Subscription for magazines paid by a Doctor for the benefit of his patients.
- ix. Major repairs to the air-conditioner in the office. (
- x. In the course of the money-lending business, the assessee acquired certain properties in lieu of debts and held them as stock-in-trade. The properties so acquired were destroyed by an enemy action and the assessee claims the loss as a deduction.
- xi. Expenses incurred in respect of a branch the business of which was discontinued during the year

## Solution :

- i. Not allowed as it has nothing to do with the purpose of the business. However, he is entitled to deduction from gross total income u/s 80GGC.
- ii. Allowed u/s 37(1).
- iii. Not allowed. The payment is just a protection money which is against public policy. [Explanation Sec. 37(1)]
- iv. It is allowed since it is reasonable. Salary paid to relatives is allowable.
- v. It is allowed provided it is reasonable.
- vi. Allowed provided it is as per Partnership Deed and fulfils all conditions of Sec. 40(b).
- vii. It is allowed provided it is reasonable.
- viii. It is allowed as it is in the interest of profession.

- ix. It is allowed provided it is in the nature of current repairs.
- x. It is allowed as it is the loss of stock-in-trade. The properties were kept as stock-in-trade.
- xi. Discontinuing a branch is not discontinuance of business. Hence, expenses are allowable.

[See CIT vs. Prithvi Insurance Co. Ltd. (1967) 63 ITR 632 (SC).]

### Illustration 5.2.6

From the following, compute the taxable income of Vineeth under the head income from business.

Profit before adjusting the following items is Rs.5,50,000.

Administration expenses 10,000

Trade expense 5,000

Household expenses 3,000

Discount allowed 4,000

Income tax 400

Provision for Bad debts 2,000

Bad debts 3,000

Donation to P.M. National relief Fund 4,000

Legal fee 200

**Solution :**

#### Computation of Business Income of Vineeth (For the assessment year 2024-2025)

Net profit	550000
Less-admissible expenses	
Administration expenses	10000
Trade expenses	5000
Discount allowed	4000
Bad debts	3000
Legal fee	200
Total expenses	22200
<b>Business income</b>	<b>527800</b>

### Illustration 5.2.7

P & L a/c of Gupta Ltd. shows a profit of Rs.50,000 after the debit of the following sums.

Particulars Rs.

Income tax paid 30,000

Travelling expenses(Business) 20,000

Penalty & Fees 40,000

Sales tax 30,000

Solution :

**(For the assessment year 2024-2025)**

Net profit	50000
Add: Inadmissible expenses	
Penalty & fees -40000	
Income tax paid -30000	
Total inadmissible expenses	70000
<b>Business income</b>	<b>120000</b>

### Illustration 5.2.8

Mr. Raju submits the following particular of his business from which you calculate from the business. For the assessment year 2024-25.

Net Profit as per P/L (before charging the following) Rs.1,25,000

1. Sales tax Rs.20,000 and Income tax Rs.55,000
2. Bad debts provision Rs.3000
3. Commission to procure business order Rs.8,000
4. Interest on capital Rs.38,000
5. Depreciation Rs.4,000 (but as per income tax rules Rs.2,000 only)

**Solution :**

**Computation of Business Income of Mr Raju for the A.Y.2024-25**

Net profit	125000
Add: Inadmissible expenses:	
Income tax 55,000	
Bad debts provision 3,000	
Interest on Capital 38,000	
Depreciation 4,000	
Add	100000
Total inadmissible expenses	225000
Less: admissible expenses	
Depreciation – 2000	
Less	2000
Total admissible expenses	
Business income	223000

**Illustration 5.2. 9**

Mr. A runs a sole proprietorship business. His Profit and Loss account for the financial year 2023-24 shows a net profit of ₹8,00,000 after charging the following:

1. Depreciation as per books: ₹50,000 (Depreciation as per Income Tax Act: ₹70,000)
2. Income Tax paid: ₹15,000
3. Donation to a political party: ₹10,000
4. Interest on capital: ₹25,000

Solution :

Compute the taxable business income.

Net Profit as per P&L Account = ₹8,00,000

Add: Expenses disallowed

- ◊ Income Tax paid = ₹15,000 (not allowed under Sec 37(1))
- ◊ Donation to political party = ₹10,000 (not deductible, but allowed as a deduction under Section 80GGC)
- ◊ Interest on capital = ₹25,000 (disallowed as per IT Act)

Less: Depreciation Adjustment

- ◊ Depreciation as per books = ₹50,000
- ◊ Depreciation as per Income Tax Act = ₹70,000
- ◊ Difference to be adjusted = ₹(70,000 - 50,000) = ₹20,000 (extra deduction)

$$\begin{aligned}\text{Taxable Business Income} &= ₹8,00,000 + ₹15,000 + ₹10,000 + ₹25,000 - ₹20,000 \\ &= ₹8,30,000\end{aligned}$$

### Illustration 5.2.10

Dr. Jyothish is a practising doctor. His income and expenses for the year 2023-24 are as follows:

- ◊ Consultation Fees: ₹10,00,000
- ◊ Gifts from Patients: ₹50,000
- ◊ Rent for Clinic: ₹2,00,000
- ◊ Salary to Staff: ₹3,00,000
- ◊ Medical Equipment purchased: ₹1,50,000
- ◊ Depreciation on Equipment as per IT Act: ₹30,000

Calculate taxable income from profession. For the assessment year 2024- 25

Solution :

Gross Receipts:

- ◊ Consultation Fees = ₹10,00,000
- ◊ Gifts from Patients (taxable as professional income) = ₹50,000

Total Income = ₹10,50,000

Less: Allowable Expenses

- ◊ Rent for Clinic = ₹2,00,000
- ◊ Salary to Staff = ₹3,00,000
- ◊ Depreciation on Equipment = ₹30,000 (allowed under IT Act)

$$\begin{aligned}\text{Taxable Professional Income} &= ₹10,50,000 - ₹2,00,000 - ₹3,00,000 - ₹30,000 \\ &= ₹5,20,000\end{aligned}$$

### Illustration 5.2.11

Mr. R is a businessman. His Profit and Loss account shows a net profit of ₹5,00,000 after considering the following expenses:

1. Salary to employees: ₹1,20,000
2. Salary to self: ₹2,00,000
3. Payment to contractor without TDS: ₹50,000
4. Interest on loan for business: ₹40,000
5. Advertisement in a political magazine: ₹20,000

Compute the taxable business income.

Solution :

Net Profit as per P&L Account = ₹5,00,000

### **Add: Disallowed Expenses**

- ◊ Salary to self = ₹2,00,000 (not allowed as per IT Act)
- ◊ Payment to contractor without TDS = ₹50,000 (disallowed as per Sec 40(a) (ia))
- ◊ Advertisement in a political magazine = ₹20,000 (not allowed under Sec 37(2B))

### **Allowable Expenses (No adjustment needed)**

- ◊ Salary to employees = ₹1,20,000 (allowed)
- ◊ Interest on loan for business = ₹40,000 (allowed)

Taxable Business Income = ₹5,00,000 + ₹2,00,000 + ₹50,000 + ₹20,000

$$= ₹7,70,000$$

(note: allowable expenses are already deducted from the net profit)

### **Illustration 5.2.12**

Mr. S is running a business and also has a part-time profession. His details for FY 2023-24 are as follows:

- ◊ Business Income (before adjustments): ₹8,00,000
- ◊ Professional Income: ₹3,50,000
- ◊ Capital Gains from selling a property: ₹2,00,000
- ◊ Allowed Depreciation: ₹50,000
- ◊ Interest on bank loan for business: ₹40,000

Compute the Gross Total Income. For the assessment year 2024-25:

Solution :

Income from Business & Profession:

- ◊ Business Income = ₹8,00,000
- ◊ Add: Professional Income = ₹3,50,000
- ◊ Less: Allowed Depreciation = ₹50,000
- ◊ Less: Interest on bank loan = ₹40,000

Net Income from Business & Profession = ₹8,00,000 + ₹3,50,000 - ₹50,000 - ₹40,000

$$= ₹10,60,000$$

Income from Capital Gains:

₹2,00,000 (fully taxable)

$$\begin{aligned}\text{Gross Total Income} &= ₹10,60,000 + ₹2,00,000 \\ &= ₹12,60,00\end{aligned}$$

### Illustration 5.2.13

The following is the Profit and Loss Account of the Raj Oil Mills for the year ending 31.03.2024

Compute its business income on the basis of additional information.

Profit and Loss Account (For the year ended 31<sup>st</sup> March, 2024)

Particulars	Rs	Particulars	Rs
Office Salaries	15,000	Gross Profits	80,000
General Expenses	7,000	Profit on Sale of car	15,000
Bad Debts	1,000	Recovery of bad debts	5,000
Advertising Expenses	3,700	Interest on Govt. Securities	3,500
Insurance Premium (fire)	1,500	Dividends	3,500
Depreciation	5,000	Gifts on the occasion of Gruhapravesam	5,000
Reserve for bad debts	3,000		
Donation to a school	2,500		
Car Expenses	2,000		
Net Profit	71,300		
<b>Total</b>	<b>1,12,000</b>	<b>Total</b>	<b>1,12,000</b>

Additional information:

a. General expenses include:

- Rs 2,500 as compensation paid to an accountant who had to be removed from service in the interest of business, and
- Rs.3,300 as contribution paid to the Govt. for laying electric cables for the company's plant

b. Depreciation as regards to the relevant blocks of assets under the Income Tax Act was Rs 3,500.

- In the assessment year 2015-16 the Assessing Officer had refused to allow deduction for the bad debts of Rs 5,000 now recovered.
- Car expenses include Rs 500 attributable to use of car for personal work.

**Solution :**

**Computation of Income from Business AY : 2024-25**

	Particulars	Rs.	Rs.
	Profit as per P & L A/c		71,300
Add :	Disallowable Expenses		
	Depreciation	5,000	
	Reserve for bad debts	3,000	
	Donation to School	2,500	
	Car expenses	500	11,000
			82,300
Less	Profit of sale of car	15,000	
	Recovery of Bad debts	5,000	
	Interest on Govt. Securities	3,500	
	Dividends	3,500	
	Gifts on the occasion of Gruhapravesam	5,000	
	Depreciation	3,500	35,500
	<b>Taxable income from Business</b>		<b>46,800</b>

**Illustration 5.2.14**

From the Profit & Loss Account for the relevant assessment year, compute income from business of Sri Babu Rao.

Profit and Loss Account (For the year ended 31<sup>st</sup> March, 2024)

Particulars	Rs	Particulars	Rs
To Salaries	88,000	By Gross Profit	3,80,000
To Rent	42,000	By Sundry receipts	20,000
To General expenses	20,000	By dividends	40,000
To Advertisement	25,000	By Commission	30,000
To Legal expenses	15,000	By Bad debts recovered	10,000
To Sales-tax	10,000	(earlier allowed)	
To Wealth-tax	20,000	By Rent of building let out	44,000
To Telephone expenses	12,000		
To Gratuity paid	30,000		
To Provision for bad debts	10,000		
To Advance income-tax	20,000		
To Depreciation	38,000		
To Office expenses	12,000		
To Municipal taxes of property let out	10,000		
To Contribution to employees provident fund	6,000		
To Net profit	1,66,000		
<b>Total</b>	<b>5,24,000</b>	<b>Total</b>	<b>5,24,000</b>

Other information:

- a. Legal expenses were found to have been incurred for the registration of a business asset.
- b. 50% of the business premises were used for residential purposes.
- c. General expenses include a donation of Rs. 10,000 towards chief minister flood relief fund.
- d. Advertisement expenses were paid in cash.
- e. Allowable depreciation as per income-tax rules, Rs 46,000.

**Solution :**

**Computation of Income from Business AY : 2024-25**

	<b>Particulars</b>	<b>Rs.</b>	<b>Rs.</b>
	Profit as per P & L A/c		1,66,000
Add :	Inadmissible Expenses		
	Rent	21,000	
	General Expenses(Donation)	10,000	
	Advertisement expenses (Paid in cash)	25,000	
	Wealth tax	20,000	
	Provision for bad debts	10,000	
	Advance Income Tax	20,000	
	Depreciation	38,000	
	Municipal Tax of property let out	10,000	1,54,000
			3,20,000
Less	Inadmissible Incomes		
	Dividends	40,000	
	Rent of building let out	44,000	84,000
	Depreciation	46,000	
	<b>Taxable income from Business</b>		<b>1,90,000</b>

## Recap

- ◊ Profit earned from running a business or profession is taxable under the head "Profits and Gains from Business or Profession".
- ◊ Computation begins with Net Profit as per the Profit & Loss Account.
- ◊ Expenses not allowed under tax laws (like personal expenses, penalties, income tax, etc.) must be added back.
- ◊ Add back provisions for bad debts, gratuity, etc., if not allowed as deductions under tax laws.
- ◊ Incomes not related to business (like capital gains, dividends, or lottery winnings) should be deducted.
- ◊ Deduct expenses specifically allowed under the Income Tax Act (like depreciation, scientific research expenses).
- ◊ Agricultural income and other exempt incomes should be reduced.
- ◊ For small taxpayers, income may be computed on a presumptive basis under sections like 44AD, 44ADA, etc.
- ◊ The amount after adjustments is called Taxable Business Income.

## Objective Questions

1. Section dealing with depreciation.
2. Maximum interest allowed on partner's capital?
3. Maximum cash expense allowed in a day?
4. Method of depreciation under the Income Tax Act?
5. Head under which business income is taxed?
6. Number of years business loss can be carried forward?
7. Section for disallowance of cash payments?
8. Depreciation rate for computers?
9. Depreciation rate for furniture?
10. Tax treatment of illegal business income?
11. Interest on bank loan for business – Allowed or Disallowed?

## Answers

1. Section 32
2. 12%
3. 10000
4. WDV
5. Profits and gains of business or profession
6. 8 years
7. Section 40A(3)
8. 40%
9. 10%
10. Taxable
11. Allowed

## Assignments

1. From the following Profit and Loss Account of a sole proprietorship business for the year ended 31<sup>st</sup> March, 2019, compute his taxable income from business and the gross total income for the assessment year 24 -25 Profit and Loss Account (For the year ended 31<sup>st</sup> March, 2024)

Particulars	Rs	Particulars	Rs
Salary to Staff	15,000	Gross Profit b/d	2,00,000
General Expenses	8,000	Dividend from an Indian	5,000
Bad Debts	3,000	Agricultural Company	
Advertisement	5,000	Interest on Notified	1,000
Proprietor's Salary	15,000	Capital Investment Bonds	
Int. on Proprietor's Capital	3,000		
Reserve for Sales Tax	8,000		
Gratuity to Staff	40,000		
Donation	12,000		
Purchase of Land	20,000		
Advance Income Tax Paid	5,000		
Depreciation	10,000		
Legal charges for defending a suit for breach of a trading contract	1,000		
Net Profit	61,000		
Total	2,06,000	Total	2,06,000

**Additional Information:**

- a. General Expenses include Rs 2,000 paid as compensation to an employee whose services were terminated as his continuing in service was considered detrimental to the profitable conduct of the business.
- b. The assessee has received demand notice of sales-tax for the preceding year amounting to Rs 8,000 and he has not disputed the liability.
- c. The gratuity paid had no relation to the service or salary drawn by the staff. It was given on ad hoc basis.
- d. Donation was given to the Chamber of Commerce to work against the threat of nationalization of the type of business carried on by the assessee. The Chamber collected such donations from several other parties also doing the same type of business. The Chamber in turn donated money to different parties who exercised their pressure with the Government and ultimately it was averted.
- e. The assessee purchased land in the name of the District Magistrate for constructing houses for its workers. It was to be done by the Government under the subsidized Housing Scheme for industrial workers. The ownership would vest in the Government.
- f. Depreciation is found to be in excess by Rs 2,000.

2. Sri Pandey is a reputed Vakil of Bikaner. He has prepared the following Income & Expenditure Account for the year ended 31<sup>st</sup> March, 2024

Profit and Loss Account (For the year ended 31<sup>st</sup> March, 2024)

<b>Expenditure</b>	<b>Rs</b>	<b>Income</b>	<b>Rs</b>
Household Expenses	12,000	Legal fees	1,26,000
Office Expenses	7,000	Special commission	1,400
Charity	500	appointment Fees	
Telephone Expenses	500	Cash gifts received from Clients	2,000
Income Tax	900	House Rent	15,000
Rent	4,000	Int. on Govt. Securities	3,000
Gift to daughter	2,000	Salary as part-time	6,000
Electricity Charges	1,000	Lecturer in Law	
Donation to National Defense Fund	1,000		
Contribution to Public Provident Fund	2,400		
Books for profession (Annual publications)	3,000		
Salaries	15,000		
Purchase of Motor-car	60,000		
Purchase of Furniture	2,000		
Life Insurance Premium	5,000		
Motor-car Expenses	6,000		
Purchase of Typewriter	6,000		
Excess of Income over Expenditure	25,100		
Total	1,53,400	Total	3,53,400

Following other particulars were received:

- Sri Pandey lives in one-half of the house and the other half is used for office. Rent and Electricity charges are in respect of this house.
- One-half of car expenses are for personal use.
- Depreciate Motor-car @ 15%, Typewriter @ 15% and Furniture @ 10%. Compute his taxable income from business and profession for the A.Y.
- Sri Sunil Dutta furnishes the following information relevant for the A.Y. 2024-25:

Profit and Loss Account (For the year ended 31<sup>st</sup> March, 2024)

Particulars	Rs	Particulars	Rs
Office Expenses	45,000	Gross Profit	3,43,000
Sundry Expenses	39,000	Sundry Receipts	11,000
Entertainment Expenses	15,000	Bad debts recovered	7,100
Audit Fees	12,000	(Not allowed earlier)	
Legal Charges	4,000	Customs duties	32,500
Extension of Building	6,000	recovered from the	
Bonus to Staff	36,000	Government (Allowed	
Salary to Staff	43,000	earlier as deduction)	
Depreciation on Plant & Machinery	23,000	Gifts received from	1,43,000
Contribution towards Recognised P.F.	15,000	father	
Contribution towards Unapproved Gratuity Fund	4,000		
Provision for Sales Tax	25,000		
Sales Tax	38,000		
Payment to a National Laboratory for Scientific Research	49,600		
Net Profit	1,82,000		
Total	5,36,600	Total	5,36,600

Additional Information:

- Payment to a National Laboratory is for the purpose of carrying on approved scientific research, not related to the business. Besides, Sri Sunil Dutta purchases a plant of Rs 30,000 for the purpose of carrying on scientific research related to the business. Neither cost of plant nor depreciation thereon is debited to profit and loss account.

b. Depreciation on plant and machinery and extension of building as per income-tax rule is Rs 19,000.

c. Sales tax of Rs 38,000 includes interest for late payment of sales tax Rs 1,200 and penalty for evading GST Rs 10,000.

d. Provision for sales tax is however paid on July 10, 2015. Evidence of payment is submitted along with the return of income.

e. Salary to staff includes a payment of pension of Rs 8,000 to the widow of a former employee. Compute business income of Sri Sunil Dutta for the assessment year 2024-25.

4. Mr. Dewan is a Chartered Accountant in Delhi. From the following information, compute the income from profession.

Income and Expenditure Account (For the year ended 31<sup>st</sup> March, 2024)

Expenses	Rs	Income	Rs
To Drawings	8,000	By Audit fees	2,24,000
To Office rent	42,000	By Financial consultancy service	98,000
To Telephone charges	15,000	By Dividend from UTI	10,000
To Electricity Bill	4,200	By Accountancy works	14,000
To Salary of staff	66,000		
To Car expenses	21,000		
To Subscription for journals	2,500		
To Institution fee	1,200		
To Stipends given to Trainees	12,000		
To Net Profit/Income	1,74,100		
Total	3,46,000	Total	3,46,000

**Notes:**

1. Depreciation of car during the year amounts to Rs 5,000.
2. 30% of the car is used for personal purpose.
5. Compute the taxable income from the following information:

Income and Expenditure Account (For the year ended 31<sup>st</sup> March, 2024)

Receipts	Rs	Payments	Rs
Balance b/d	14,000	Electricity and Water Bills	2,000
Consultation Fees:		Rent of Clinic:	
2013-14	3,000	2013-14	600
2014-15	15,000	2014-15	4,800

2015-16	2,000	2015-16	600
Visiting Fees	30,000	Purchase of medicines	40,000
Loan from bank for professional purposes	25,000	Purchases of Professional Books	4,000
Sale of Medicines	60,000	Household expenses	7,800
Gifts and Presents	5,000	Collection charges on Dividend Income	100
Remuneration from Articles Published in Professional Journals	6,000	Motor-car purchased	30,000
		Surgical Equipments	4,800
		Income Tax	10,000
Dividend	10,000	Salary to Staff	15,000
Interest on Post Office Savings Bank A/c	7,000	Life Insurance Premium	15,000
		Gift to Wife	5,000
		Interest on Loan	2,000
		Car expenses	15,000
		Balance c/d	20,300
Total	1,77,000	Total	1,77,000

Compute his Taxable Professional Income for the assessment year 2024-25, after taking into account the following additional information:

- 1/3 of the use of Motor-car relates to his personal use.
- Depreciation on Motor-car allowable is 15%, on books it is @ 100% and on Surgical Equipments it is @ 15%.
- Gifts and presents include Rs. 3,000 from patients in appreciation of his medical service and Rs 2,000 received as Birthday Gifts from relatives.
- Closing stock of medicine amounted to Rs. 5,500.

6. The following is the Receipts and Payments Account of Mr. Nagaraja Rao, a practicing Chartered Accountant for the year ended 31.3.2024:

Receipts	Rs.
Audit Fees	19,210
Consultation	10,000
Appellate Tribunal appearance	15,000
Miscellaneous	20,000
Interest on Government Securities	10,000
Rent received	10,000

Payments	Rs.
Presents from clients	10,000
Office expenses	10,000
Office rent	5,000
Salaries and Wages	12,050
Printing and Stationery	1,000
Subscription to C.A. Institute	3,000
Purchase of books for professional purposes (Annual publications)	1,300
Travelling expenses	5,800
Interest on bank loan	3,000
Donation to National Defense Fund	5,000
Loan from bank was taken for the construction of the house in which he lives. Municipal value of this house is Rs 8,000 and the local taxes Rs 800 p.a. 1/4th of travelling expenses are not allowable. Compute professional income and income from house property for the previous year	
7. Dr. Gupta is a medical practitioner of Ludhiana. From the following, calculate his income from profession for the assessment year 2024-25:	
Rs.	
1. Gross receipts from dispensary	2,35,000
2. Gross receipts from consultation	1,65,000
3. Operation fees	2,50,000
4. Visiting fees	50,000
5. Gifts from patients	30,000
6. Medicine purchased	1,25,000
7. Closing stock of medicines	35,000
8. Salaries paid to employee	1,50,000
9. Surgical equipments purchased	48,000
10. Dr. Gupta went to attend a medical seminar in Germany to update the knowledge and spent Rs 25,000 on it.	
11. He owns a house whose municipal value is Rs 50,000. Half portion of the house is used for profession. Expenses paid on the house: Municipal Taxes 10% of M.V., Repairs Rs 10,000.	

12. Medical books purchased (Allow depreciation @ 40%) Rs. 30,000

8. Sri Rathore gives you the following particulars from his books of account. Compute his Taxable Business Income for the year ending 31.3.2024:

Net profit as per Profit and Loss A/C (Before charging the following) Rs. 5,75,000 Expenditure on Family planning Rs. 45,000

Lump-sum payment made for Technical know-how Rs 90,000 Entertainment expenditure Rs. 30,000

Expenditure on acquiring Patent-Right Rs. 84,000 Expenditure on advertisement – Paid in Cash Rs. 18,000

Amount paid to Rajasthan University for an approved Research Programme in Social Sciences not connected with his business Rs. 20,000

Provision for Excise duty (He paid only Rs 20,000 before filing I.T. return) Rs 45,000.

9. Miss. Vishnu Priya gives you the following information from her accounts for the year ending 31.3.2024:

Net profit as per the Profit and Loss Account (Before charging the following) Rs. 5,40,000 Expenditure on staff welfare Rs. 30,000

Revenue expenditure on family planning among employees Rs. 32,000 Capital expenditure on the above Rs. 8,00,000

Lump sum consideration for purchase of technical know-how on 1.7.2013 Rs. 1,00,000 Entertainment expenditure Rs. 15,000

Expenditure on acquisition of patent right on 1.11.2012 Rs. 1,25,000 Expenditure on advertisement paid in cash Rs. 90,000

Amount paid to Anna University for an approved research programme in the field of social science not connected with the Business Rs. 40,000

Compute business income of Vishnu Priya for the assessment year 2024-25.

10. The Net profit of Mr. Sulaiman of Madurai as per his profit and loss account for the year ended 31.3.2024 after charging the following item was Rs 2,40,000.

- Interest on capital Rs. 20,000
- Salary to staff Rs. 1,16,000
- Office expenses Rs. 3,000

- d. Bad debts written-off Rs. 13,000
- e. Provision for bad debts Rs. 10,000
- f. Provision for income-tax Rs. 16,000
- g. Donation Rs. 10,000
- h. Depreciation Rs. 17,000

Depreciation allowable as per the Act is only Rs. 12,000.

Compute income from business.

11. Mr. Gupta provides you the following detail from his business books for the assessment year 2024-25:

- a. Computed net profit after charging the following Rs. 72,000
- b. Provision and reserves debited to P & L A/c.
- 1. Provision for Discount on Debtors Rs. 42,000
- 2. Provision for Depreciation Rs. 31,000
- c. Household expenses Rs. 48,000
- d. Donation to a recognised school Rs. 70,000
- e. Computer purchased for scientific research Rs. 20,000
- f. Bearer cheque issued for a purchase Rs 25,000
- g. O. Y. T. deposit Rs. 16,000
- h. Advertisement expenses on sign boards Rs. 45,000
- i. Audit fees paid in cash Rs. 25,000
- j. Patent purchased during the year Rs. 75,000
- k. Market survey and feasibility report expenses (Cost of a new project Rs 6,00,000) Rs. 50,000
- l. Opening stock is valued at cost + 10% basis and closing stock is valued at cost - 10% basis. Opening stock was valued at Rs 66,000 and closing stock was valued at Rs. 72,000. Income credited to Profit and Loss account were:
  - 1. Bank Interest on F. D. Rs. 7,000
  - 2. Refund of Excise Duty Rs. 5,000
  - 3. Dividend from Indian Cos. Rs. 3,000
  - 4. Bad debts recovered Rs. 3,000

Compute Business Income of the assessee for the assessment year 2024-25. Give proper notes in support of your answer.

## Reference

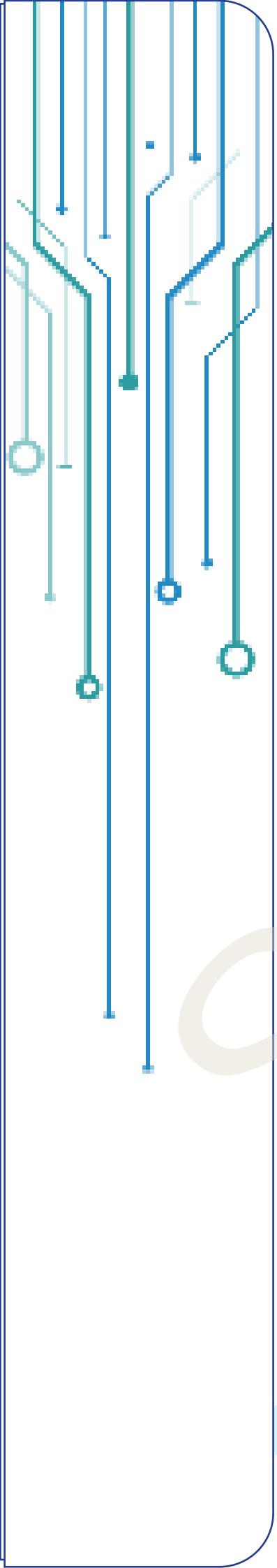
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# 6 BLOCK

## Capital Gains



# Unit 1

## Introduction

### Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ comprehend the scope of income chargeable under the head income from capital gain
- ◊ differentiate between short-term capital gain and long-term capital gain
- ◊ identify the transactions to be considered as the transfer for the purpose of capital gain

### Prerequisites

Rohit, a young professional living in Trivandrum who invested in real estate to build long-term wealth. In 2018, he purchased a small flat on the outskirts of the city for ₹30 lakhs. Over the years, the area developed with improved infrastructure, schools, and commercial spaces, which significantly increased the property's market value. In 2024, Rohit sold the flat for ₹55 lakhs. The profit of ₹25 lakhs from the sale is known as capital gain. Since the flat was held for more than two years, it qualifies as a long-term capital gain, which is taxed at a lower rate compared to short-term gains. Rohit is required to report this gain while filing his income tax return. Similarly, his wife Meena, a college professor, decided to invest ₹1, 00,000 in shares of a reputed Indian IT company in 2021. Over three years, her investment grew to ₹1, 60,000 due to the company's steady growth and rising share prices. When she sold the shares in 2024, she earned a capital gain of ₹60,000. Since the shares were listed and held for more than one year, the gain qualifies as a long-term capital gain under Indian tax laws. Rohit's sale of real estate and Meena's sale

of shares clearly illustrate the concept of income from capital gain. This type of income is not earned on a regular basis like salary or rent. Instead, it arises when an individual makes an investment, the value of that investment increases over time, and it is eventually sold for a profit.

## Keywords

Short term capital assets, Long term capital assets, Full Value of Consideration, Cost of Acquisition

## Discussion

Income from Capital gain is the fourth head of income, taxable under the Income Tax act. Section 45 to 55 deals with capital gain. Capital gain is concerned with the transfer of capital asset. Profit or gains arising from the transfer of a capital asset made in a previous year is taxable under the head “Capital Gains”. The tax levied on the profit or gain earned on selling capital assets is called capital gain tax.

Capital gains, a crucial aspect of income tax, arise from the profit generated when a capital asset is sold or transferred. These assets can range from stocks and bonds to real estate and jewellery. Understanding capital gains is essential for effective financial planning and tax compliance.

The taxation of capital gains is structured to differentiate between short-term and long-term gains, each with distinct tax implications. Short-term capital gains, derived from assets held for a shorter duration, are generally taxed at the taxpayer's regular income tax rates. Long-term capital gains, resulting from assets held for a longer period, often benefit from lower tax rates, incentivizing long-term investments.

The determination of capital gain involves calculating the difference between the asset's sale price and its purchase price, adjusted for any improvements or expenses. This difference, the capital gain, is then subject to taxation based on the holding period and prevailing tax laws. Various exemptions may apply, depending on the asset type and specific circumstances, making it vital to consult tax professionals or refer to official tax guidelines. Effectively managing capital gains can significantly impact an individual's or entity's overall tax liability.

### 6.1.1. Basis of charge

The basis of charge is the profits or gains arising from the transfer of capital asset in the previous year. It is taxable under the head capital gains. Capital gains shall be chargeable to tax if the following conditions are satisfied: -

1. There should be a capital asset. In other words, the asset transferred should be a capital asset on the date of transfer.
2. It should be transferred by the tax payer during the previous year.
3. There should be profit or gain as a result of transfer.

Thus, the essential elements of capital gains are

1. Capital asset
2. Transfer of capital asset
3. Computation of capital gains

## 1. Capital assets

- a. Property of any kind held by an assessee, whether or not connected with his business or profession,
- b. Any securities held by a Foreign Institutional Investor in such securities in accordance with the regulations made under SEBI Act, 1992,
- c. Any unit linked insurance policy to which exemption under section 10(10D) does not apply.

Capital assets maybe movable or immovable, tangible or intangible, fixed or floating. Capital asset includes land, building, plant, machinery, investments, goodwill, leasehold rights, jewellery, shares, a manufacturing license etc.

Property includes any rights in, or in relation to an Indian company including rights of management or control or any other rights whatsoever.

Business undertaking is a capital asset. Gains on transfer of business undertaking are assessable as Capital gains.

However, it does not include

### i. Stock-in trade

Any stock-in-trade consumable stores or raw materials held for the purpose of business or profession of the assessee;

### ii. Personal effects

Personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him.

Exception :

- a. Jewellery for personal use
- b. Archaeological collections;
- c. Drawings;
- d. Paintings;

- e. Sculptures
- f. Any work of art.
- g. Jewellery for personal use
- iii. Rural agricultural land in India

Agricultural land in India which is not situated in any specified area.

As per the definition, only rural agricultural lands in India are excluded from the purview of the term 'capital asset'. Hence urban agricultural lands constitute capital assets

### 6.1.2 Types of capital assets

Capital assets are divided into two categories

- ◊ Short term capital assets
- ◊ Long term capital assets

#### 6.1.2.1. Short term capital assets

As per section 2(42A), 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. However, w.e.f. 23.7.2024, a capital asset will be a short-term capital asset if it is held by an assessee for not more than 24 months immediately preceding the date of its transfer. Capital gains arising from the transfer of short term capital assets is called short term capital gain.

##### Exceptions

1. In the case of a financial asset, being (a) security (other than a unit) listed in a recognised stock exchange in India, or (b) a unit of the Unit Trust of India, or (c) a unit of an equity oriented fund, or (d) Zero coupon bond, short-term capital asset will mean a security or unit or zero coupon bond held by the assessee for not more than 12 months.

In the case of a financial asset, as aforesaid, which is allotted without any payment (like bonus shares) on the basis of holding of any other financial asset, the period of its holding shall be reckoned from the date of the allotment of such financial asset

2. If unlisted share (not listed in a recognised stock exchange in India) of a company or land or building or both is held by the assessee for not more than 24 months, immediately preceding the date of its transfer, it will be treated as short-term capital asset.
3. Assets used for business or profession, on which depreciation is allowed on the basis of WDV method is always treated as a short-term capital assets
4. In the case of a capital asset, being

- a. Electronic Gold Receipt issued in respect gold deposited as referred to in clause (viid) of section 47, there shall be included the period for which such gold was held by the assessee prior to conversion into the Electronic Gold Receipt,
- b. Gold released in respect of an Electronic Gold Receipt, as referred to in clause (viid) of section 47, there shall be included the period for which such Electronic Gold Receipt, was held by the assessee prior to its conversion into gold.

### 6.1.2.2. Long-term capital asset

As per section 2(29A), long-term capital asset means a capital asset which is not a short-term capital asset. Any capital asset held by the tax payer for a period of more than 36 months immediately preceding the date of its transfer will be treated as long term capital asset.

#### Capital Asset Classification Based on Holding Period

Before 23.07.2024

**Short-Term Capital Gain (STCG):** If held for a period *less than or equal to* the mentioned timeframe.

**Long-Term Capital Gain (LTCG):** If held for a period *greater than* the mentioned timeframe.

Type of Capital Asset	STCG if held for	LTCG if held for
Security (other than unit) listed on a recognized stock exchange	≤ 12 months	> 12 months
Unit of equity-oriented fund/unit of UTI	≤ 12 months	> 12 months
Zero Coupon bond	≤ 12 months	> 12 months
Unlisted shares	≤ 24 months	> 24 months
Land or building or both	≤ 24 months	> 24 months
Unlisted securities other than shares	≤ 36 months	> 36 months
Other capital assets	≤ 36 months	> 36 months

On or After 23.07.2024

**Short-Term Capital Gain (STCG):** If held for a period *less than or equal to* the mentioned timeframe.

**Long-Term Capital Gain (LTCG):** If held for a period *greater than* the mentioned timeframe.

Type of Capital Asset	STCG if held for	LTCG if held for
Security listed on a recognized stock exchange	≤ 12 months	> 12 months
Unit of equity-oriented fund/unit of UTI	≤ 12 months	> 12 months
Zero Coupon bond	≤ 12 months	> 12 months

### 6.1.3. Transfer of capital asset [Sec. 2(47)]

The term transfer of capital asset refers to the process by which ownership or rights over a capital asset are shifted from one party to another

“Transfer” in relation to a capital asset includes:

- (i) the sale, exchange or relinquishment of the asset; or
- (ii) the extinguishment of any rights therein, or
- (ii) its compulsory acquisition under any law, or
- (iv) where the asset is converted by the owner into stock-in-trade of a business carried on by him; or
- (iva) the maturity or redemption of a zero-coupon bond; or
- (v) conversion of a business into a limited company; or
- (vi) 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, 1982, or
- (vii) any transaction (whether by way of becoming a member of, or acquiring shares in a co-operative society, a company, etc.) which has the effect of transferring the enjoyment of any immovable property.

### 6.1.4. Computation of capital gains (Sec.48)

The income chargeable under the head 'Capital Gains' shall be computed as below

#### (a) Computation of short-term capital gains

Deduct the following amounts from the full value of the consideration received or accruing as a result of the transfer of the capital asset

- (i) the cost of acquisition of the capital asset;
- (ii) the cost of any improvement thereto; and

The cost of acquisition of the asset or the cost of improvement thereto shall not include the deductions claimed on the amount of interest u/s 24(b) or under the provisions of

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(iii) expenditure incurred wholly and exclusively in connection with such transfer.

This may be explained in the form of an equation as under:

Capital Gains = Full value of consideration - (Cost of acquisition+ Cost of improvement + Selling Expenses)

However, the amount paid as securities transaction tax shall not be allowed as a deduction.

### **Set-off of short-term capital loss**

If there is a short-term capital loss on the transfer of a short-term capital asset, such loss can be set-off against any other short-term capital gain or long-term capital gain.

### **(b) Computation of long-term capital gains**

Deduct the following amounts from the full value of the consideration received or accruing as a result of the transfer of the capital asset

- i. indexed cost of acquisition of the asset;
- ii. indexed cost of any improvement of the asset; and
- iii. expenditure incurred wholly and exclusively in connection with transfer of the asset. However, the amount paid as securities transaction tax shall not be allowed as a deduction.

### **(c) Computation of capital gains in the case of transfer of shares or debentures held by a non-resident in an Indian company**

Where a non-resident transfers shares or debentures (Short-term or Long-term) of an Indian Company the, capital gain shall be computed in the following manner:

1. Convert the cost of acquisition, selling expenses and consideration received or accruing for such transfer into the same foreign currency in which the investment was initially made and then compute the capital gain in such foreign currency.
2. Thereafter, convert the capital gain so computed into Indian currency.

### **(d) computation of capital gain in the case of depreciable assets on which depreciation is allowed on the basis of the written down value method**

The capital gains on depreciable assets shall be computed as under

- i. Find out the written down value on the first day of the previous year of all those depreciable assets on which the depreciation is allowed at the same rate. All such assets are known as block of assets
- ii. If any new asset of the same block is purchased during the previous year, the cost of such asset should be included in (1).
- iii. If any asset is sold out of such block during the previous year, the net consideration should be deducted from the balance under (ii).

ix. On the balance under (iii) compute the depreciation at the prescribed rate and

deduct it from the balance under (iii).

- The balance under (iv) shall be the written-down value of the 'block of assets' for the next year
- Reduction of the amount of goodwill of a business or profession, from the block of asset us 43(6c) (1) (B) shall be deemed to be transfer.

It means if the net consideration of an asset out of the block is less than the balance under (ii), there would be no capital gain. If the net consideration of an asset is more than the balance under (ii) (the value of all assets in the block), the excess shall be deemed to be short-term capital gain. If all the assets of the block are sold in the previous year and the net consideration is less than the balance under (ii), the loss shall be deemed to be short-term capital loss.

### Illustration 6.1.1

Anish installed a new plant for 20, 00,000 on August 31, 2020. He received a grant from the Central Government exclusively for buying the new plant amounting to ₹ 500,000. In September 2023, the plant was destroyed by fire. The assessee realised ₹2, 00,000 from the insurance company and ₹ 10,000 from scrap sale.

Compute the depreciation up to the assessment year 2023-24 and profit/loss for this plant for the assessment year 2024-25, allowing the rate of depreciation at 15%

### Solution 6.1.1

#### Computation of depreciation(for the assessment year 2024-25)

	₹
Cost of plant on 31-08-2020	2000000
Less: grant received from the central government	500000
	Net cost
	1500000
Depreciation @15% for the assessment year 2021-22	225000
written-down value on 1.4.2021	127500
Less depreciation @ 15% for the assessment year 2022-23	191250
written-down value on 1.4.2022	1083750
Less depreciation @ 15% for the assessment year 2023-24	162563
written-down value on 1.4.2023	921187
Less amount received from the insurance company	200000
Amount received from scrap	10000
	210000
Less deemed to be short term capital loss u/s 50(2) for the assessment year 2024-25	711187

**Note:** Section 5062) provides that where any block of assets ceases to exist for the reason that all the assets in the block are transferred during the previous year, the income received by such transfer shall be deemed to be short-term capital gain. Naturally the loss incurred in such a case shall be deemed to be short-term capital loss. It is assumed,

in this case, that this plant was the only asset in this block of assets, and hence the loss has been deemed to be short-term capital loan u/s 50(2).

**(e) Computation of capitals gains in the case of depreciable assets on which depreciation has been claimed on the basis of the straight line method.**

Where an aforeside asset is sold, the capital gains shall be computed keeping in view the provisions of section 48 (computation of capital gains) and section 49 (cost of acquisition).the cost of acquisition of such asset shall be the W.D.V. as adjusted. It means the W.D.V. plus balancing charge or W.D.V. plus balancing charge or W.D.V. less terminal depreciation allowed in the year of transfer shall be taken as the cost of acquisition of the asset.

**(f) Computation of capital gain in case of market linked debentures or specified mutual fund**

**(1) Transfer of unit of a Specified Mutual Fund or Market Linked Debenture**

Capital gains arising from the transfer or redemption or maturity of unit of a Specified Mutual Fund acquired on or after 1.4.2023 or Market Linked Debenture would be deemed to be short term capital gains and chargeable to tax at normal rate of tax.

**(2) Computation of Capital Gains**

The full value of consideration received or accruing as a result of the transfer or redemption or maturity of unit of a Specified Mutual Fund or Market Linked Debenture as reduced by the cost of acquisition of the debenture or unit and the expenditure incurred wholly and exclusively in connection with such transfer or redemption or maturity would be deemed to be the capital gains

**(3) No deduction in respect of Securities Transaction Tax**

No deduction would be allowed in computing Capital Gains in respect of any sum paid on account of securities transaction tax (STT)

### **6.1.5. Full Value of Consideration**

Full value means the whole price without any deduction whatsoever and it does not refer to the adequacy or inadequacy of the price bargained for. Where agreed consideration is not paid fully in the previous year, the entire consideration stated in the agreement of sale would be regarded as forming the full value of consideration and capital gains would have to be calculated on that basis. The acceptance of lesser price than the agreed consideration in the later year would not affect this matter.

In the case of exchange, the fair market value of the property granted in exchange on the date of exchange will have to be ascertained in order to arrive at the full value of consideration

**Full value of consideration of shares, etc. received under ESOP in case of Gift, etc.**

Where shares, debentures or warrants received under Employees' Stock Option Plan or Scheme are transferred under a gift or an irrevocable trust, the market value on

the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer for computation of capital gains.

### **Determination of full value of consideration of land or building or both**

Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being land or building or both is less than the value adopted or assessed or assessable by any authority of state government ('stamp valuation authority') for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall, for the purposes of section 48, be deemed to be the full value of the consideration received or accruing as a result of such transfer.

Where the value assessed by the stamp valuation authority does not exceed 110% of consideration, the consideration received or accruing shall be deemed to be the full value of consideration.

Where

- a. the assessee claims before any Assessing Officer that the value adopted or assessed or assessable by the stamp valuation authority exceeds the fair market value of the property as on the date of transfer;
- b. the value so adopted or assessed or assessable by the stamp valuation authority has not been disputed in any appeal or revision or no reference has been made before any other authority, court or the high court, the assessing officer may refer the valuation of the capital asset to a valuation officer

### **Special provision for the full value of consideration for the transfer of share other than quoted share (Sec. 50CA)**

Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, the value so determined shall, for the purposes of section 48, be deemed to be the full value of consideration received or accruing as a result of such transfer.

The provisions of this section shall not apply to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.

### **Determination of full value of consideration where it is not ascertainable (Sec. 50D)**

Where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for computing chargeable capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of the consideration received or accruing as a result of such transfer.

## 6.1.6 Cost of Acquisition

Cost of acquisition of an asset is the value for which it is acquired by the assessee. It means that whatever cost is incurred for getting an asset plus all expenses incurred to acquire it is the cost of acquisition. Interest paid on money borrowed for the purchase of a capital asset would constitute part of the cost of acquisition, provided such interest has not been deducted under any other provision. Similarly, if any loan has been taken to purchase a plot, the interest paid or payable on such loan, till the building is constructed on the plot, shall be included in the cost of land. However, in the following cases the above meaning of cost of acquisition does not hold good and cost of acquisition is taken as a notional figure.

### (1) Cost to the previous owner

In certain cases, the assessee might not have incurred any cost to acquire the asset. In such cases the cost incurred to the previous owner to acquire the asset will be the cost of acquisition. The following are the cases in which the cost incurred to the previous owner is taken as the cost of acquisition.

1. In the case of an asset distributed as a result of partition of a Hindu Undivided Family,
2. When the assessee acquires an asset under a gift or as per a will,
3. When the assessee acquires an asset by succession, inheritance or devolution,
4. When assets are distributed as a result of dissolution of a partnership firm, body of individuals or association of persons where the dissolution happened before 1.1.1987,
5. When assets are distributed as a result of liquidation of a company,
6. When the asset is acquired under a transfer to a revocable or an irrevocable trust,
7. On the transfer of an asset by a parent company to its Indian subsidiary company which is wholly owned by the parent company,
8. On the transfer of an asset by a subsidiary company to its Indian holding company which owns the whole of the shares of the subsidiary company,
9. On the transfer of capital asset by the amalgamating company to the amalgamated company, if the amalgamated company is an Indian company,
10. On the transfer of shares of an Indian company by the amalgamating foreign company to the amalgamated foreign company,

### (2) Cost of Share or Security

Where share or security was acquired before 1st April, 2001, the cost of acquisition will be taken the actual cost or fair market value on 1st April, 2001, whichever is beneficial to the assessee. If it is acquired after 31st March, 2001, the actual cost will be the cost of acquisition.

### **(3) Cost of Bonus Shares**

The cost of bonus shares or security which is received by the assessee without any payment on the basis of his holding any financial asset will be as under

- i. Where bonus share or security was received prior to 1st April, 2001, the fair market value on 1st April, 2001;
- ii. In any other case-Nil

### **(4) Cost of acquisition u/s 49(3)**

In a case where the capital gain arising from the transfer of a capital asset belonging to a holding company to its subsidiary company or belonging to a subsidiary company to its holding company under circumstances stated under the aforesaid clauses (g) and (h) respectively, it is deemed to be income chargeable under the head 'Capital Gains' u/s 47A. The cost of acquisition of such asset to the transferee company shall be the cost for which such asset was acquired by it.

### **(5) Cost of acquisition of an asset acquired by the previous owner before 1st April, 2001 by any mode u/s 49(1)**

If the capital asset (other than asset on which depreciation has been allowed) became the property of the assessee by any of the modes specified in section 49(1) and the capital asset became the property of the previous owner before 1st April, 2001, the cost of acquisition of the asset may, at the option of the assessee, be taken to be any one of the following:

- i. the cost of acquisition of the asset to the previous owner, or
- ii. the fair market value of the asset on 1st April, 2001.

If capital asset is land or building or both, the FMV of such asset on the 1st day of April 2001 will be Stamp Duty value of such asset on that date (if available)

### **(6) Cost of acquisition of shares in an amalgamated company**

If an assessee is given shares of the amalgamated company, which is an Indian Company in lieu of his shares in the amalgamating company. the cost of acquisition of such shares shall be his cost of shares in the amalgamating company. (Sec. 49(2)]

### **(7) Cost of acquisition of shares or debentures**

The cost of acquisition of shares or debentures of a company acquired in consideration of the conversion of debenture, debenture-stock or deposit certificate, shall be deemed to be the cost of the original debentures, debenture-stocks or deposit certificates converted. [Sec. 49(2A)]

### **(8) Cost of stock options to employees**

Where capital gains arise from the transfer of specified security or sweat equity shares, the cost of acquisition of it shall be the fair market value which has been taken into account while computing the value of perquisite u/s 17(2)

**(8a) Cost of acquisition of capital asset being rights of a partner in the limited liability partnership**

Where a private company or unlisted public company is converted into a limited liability partnership, the cost of acquisition of above mentioned capital asset to the partner shall be deemed to be the cost of acquisition of shares in the company immediately before its conversion.[Sec. 49 (2AAA)]

**(8b) Cost of acquisition of capital asset being a unit of a business trust**

Where the aforesaid asset became the property of the assessee in consideration of a transfer of share of a special purpose vehicle, the cost of acquisition of the unit shall be deemed to be cost of share.[Sec. 49(2AC)]

**(8c) Cost of equity shares in lieu of preference shares**

Where equity shares of a company are issued in lieu of preference shares of that company, the cost of equity shares shall be the cost of preference shares in relation to which such asset is acquired. [Sec. 49(2AE)]

**(8d) Cost of acquisition of capital asset being a unit or units in consolidated plan of mutual fund scheme.**

The cost of new unit or units shall be deemed to be the cost of acquisition to him the cost of original unit or units. [Sec. 49(2AF)]

(8E) Cost of acquisition of a unit or units in the segregated portfolio shall be the amount which bears to the cost of acquisition of a unit or units held by the assessee in the total portfolio the same proportion as the net asset value of the assets transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios.

(8F). Cost of acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the amount as so arrived at under sub-section (2AG).

(9G) Where the capital asset, being shares as referred to in section 47(xx), became the property of the assessee, the cost of acquisition of such asset shall be deemed to be the cost of acquisition to it of the interest in the joint venture referred to in the said clause.

**(10) Cost of acquisition of an asset acquired on distribution of capital assets of a company on its liquidation**

Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to income tax under the head Capital Gains' in respect of the asset u/s 46, the cost of acquisition to him shall be the fair market value of the asset on the date of distribution.

## **(11) Cost of equity shares allotted in lieu of membership of stock exchange**

The cost of equity share or shares allotted to a shareholder of a recognised stock exchange in India under a scheme for corporatisation or demutualisation approved by the SEBI shall be the cost of acquisition of his original membership of the exchange.

However, the cost of a capital asset, being trading or clearing rights of the recognised stock exchange acquired by a shareholder who has been allotted equity shares under the scheme of demutualisation or corporatisation shall be deemed to be nil.

## **(12) Cost of acquisition on consolidation or conversion of shares**

Where the capital asset, being a share or a stock of a company, became the property of the assessee on the consolidation and division of shares into shares of larger amount than its existing shares, or on the conversion or reconversion of any shares into stock or vice-versa, or on the sub-division of any shares into shares of smaller amount or on the conversion of one kind of shares into another kind, the cost of acquisition shall be taken to be the cost to the assessee of the original shares or stock held by him.

## **(13) Cost of acquisition in case of advance money received as a result of previous negotiation for transfer with someone else.**

Where any capital asset was, on any previous occasion, the subject of negotiation for its transfer any advance or other money received and retained by the assessee in respect of such negotiation shall be deducted from the cost for which the asset was acquired or the written-down value, or the fair market value, as the case may be, in computing the cost of acquisition. However, where such advance is received and forfeited on or after 1.4.2014, it shall be deemed to be the income of the assessee and chargeable under the head Income from Other Sources. It shall not be deducted from the cost of acquisition.

## **(14) Cost of acquisition in case of devaluation of the rupee**

For the purpose of computing the capital gains arising to the assessee on the sale of transfer of a capital asset acquired by him from abroad on deferred payment terms or against a foreign loan (along with interest, if any), as the case may be, after devaluation of the rupee, will be added to the original actual cost of the asset and the resultant amount will be taken as the cost of acquisition of the capital asset.

## **(15) Cost of securities held with depository**

The cost of acquisition and the period of holding of any securities with the depository shall be determined on the basis of the first-in-first-out method.

## **(16) Cost of shares in resulting company**

The cost of acquisition of shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

### **(17) Cost of shares in demerged company**

The cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived at under (18)

### **(18) Property received without consideration or for inadequate consideration**

1. The cost of acquisition of immovable property shall be the stamp duty value or value determined u/s 50C
2. The cost of acquisition of property other than immovable property shall be the fair market value determined for income-tax purposes u/s 56.

### **(19) Cost of acquisition of shares on redemption of Global Depository Receipts**

Where the capital asset, being share/s of a company, is acquired by a non-resident assessee on redemption of Global Depository Receipts, the cost of acquisition of the shares shall be the price of such shares prevailing on any recognised stock exchange on the date on which a request for such redemption was made.

## **6.1.7.Cost of Improvement**

An assessee can deduct cost of acquisition as well as cost of improvement of the asset from the full value of consideration, to determine the capital gain on the transfer of the asset. The cost of improvement will be ascertained as follows.

- i. In the case of a capital asset being goodwill of a business or profession, right to manufacture, produce or process any article or thing, right to carry on any business or profession, cost of improvement shall be nil.
- ii. In the case of any other capital asset acquired by the assessee or the previous owner before 1.4.2001, cost of improvement or addition to the asset on or after 1.4.2001 only shall be deducted to determine capital gain. This means that the expenditure on additions or alterations to the capital asset before 1.4.2001 either by the assessee or by the previous owner shall not be taken into account.
- iii. In any other case, expenditure of capital nature incurred in making any additions or alterations to the capital asset by the assessee after acquisition shall be considered as cost of improvement.

Based on the above rules cost of improvement can be ascertained as follows.

1. Cost of improvement of goodwill or right to manufacture, produce or process - Nil
2. Asset acquired prior to 1st April, 2001, cost of improvement on or after 1.4.2001.
3. Asset acquired after 1st April 2001, any cost of improvement after acquisition.

### **Selling expense**

Selling expense like commission to brokers, registration fee paid by the assessee, advertisement expenses, etc., can be deducted from the full value of consideration to ascertain the capital gain. However, such expenditure must be in connection with the

transfer of capital asset. Securities transaction tax (STT paid) paid on sale of securities is not an expense for sale and hence not deductible.

### **Indexed Cost of Acquisition**

Indexed cost of acquisition is the cost of acquisition indexed by applying cost inflation index (CII). It is done to adjust for inflation over the years of holding of the asset. This increases one's cost base and lowers the capital gains.

Indexed cost of acquisition is calculated as follows :

Cost of acquisition  $\times$  CII of year of transfer / CII year of acquisition

### **Indexed Cost of Improvement**

Expenditure incurred on any improvement in asset is permitted as deduction and that cost can also be adjusted on the same principles as above. It is calculated as follows:

Cost of Improvement  $\times$  CII of year of transfer / CII year of improvement

#### **Illustration 6.1.2**

Mr. Arun purchased 1000 equity shares of X Ltd. at the rate of 50 per share on 1.1.2001. On 31.1.2002 he was allotted 200 bonus shares. The market value of the shares on 1.4.2002 was 80 per share. He sold the shares in March 2024 at the rate of 1,000 per share (STT paid). Determine the capital gain taxable for the year 2023-24. Cost inflation index: 2002-03-100, 2023-24-331. Market value of share on 31.1.2019 ₹ 560.

#### **Solution 6.1.2**

##### **Computation of capital gain for the P.Y. 2023-24**

Full value of consideration (1,200 $\times$ 1000)	1200000
Less: Cost of acquisition (1,200 $\times$ 560)	672000
Long term capital gain	528000
Less LTCG not taxable	100000
Capital gain taxable at the rate of 10% plus cess	428000

#### **Illustration 6.1.3**

Mr. Arunima purchased a plot of urban land in 1990 at a cost of ₹ 1,00,000. She constructed a house there spending 12,00,000. Immediately, he spent 3,00,000 to modify the house. In March 2001 she constructed two additional rooms to the building at a cost of ₹ 4,00,000. In April 2009, he again spent 8,00,000 to remodel the house. Finally, he sold the house in April 2022 for 90,00,000. Find out taxable capital gain for the financial year 2022-23 if the fair market value of the house on 1.4.2001 was 30,00,000.

Cost inflation index: 2001-02-100, 2009-10-148, 2022-23-331.

### Solution 6.1.3

#### Computation of capital gain for the year 2022-23

Full value of consideration	9000000
Less Cost of acquisition or FMV on 1.4.2001, whichever is higher (indexed) $(30,00,000/100) \times 331$	9930000
Indexed cost of improvement $(8,00,000/148) \times 331$	1789190
Long term capital loss	2719190

### Illustration 6.1.4

From the following information compute capital gains for the year 2023-24 in respect of Mr. Kumar.

	House I (₹)	House II(₹)
Date of purchase	2 May 1997	2 Dec. 2000
Cost of acquisition	3,80,000	500000
Cost of additional construction in 2000	20,000	50,000
Fair market value on 1.4.2002	3,50,000	25,00,000
Cost of additional construction in 2014-15	300000	1000000
Sold the property in January 2024 for	12,00,000	98,00,000
Selling expenses	25,000	50,000

Cost inflation index: 2001-02-100, 2013-14-220, 2022-23-331.

### Solution 6.1.4

#### Computation of capital gains for the year 2023-24

House I	(₹)
Full value of consideration	12,00,000
Less: Selling expenses	25,000
	11,75,000
Less: Indexed cost of acquisition $(3,80,000/100) \times 331$	12,57,800
Indexed cost of improvement $(3,00,000/220) \times 331$	4,51,364
Long term capital loss	5,34,164

#### House II

Full value of consideration	9900000
Less: Selling expenses	50000
	9850000
Less: Cost of acquisition or FMV on 1.4.2002 whichever is higher, indexed $(25,00,000/100) \times 331$	82,75,000
Indexed cost of improvement $(10,00,000/220) \times 331$	15,04,546
Long term capital gain	70,454
Net long term capital loss $(5,34,164-70,454)$	4,63,710

### Illustration 6.1.5

From the following information compute capital gains for the year 2023-24 in respect of Mr Vikas.

	House I ₹	House II
Date of Purchase:	2 May 1997	2 Dec 2000
Cost of Acquisition	3,90,000	5,20,000
Cost of Additional Construction (2000)	25,000	55,000
Fair Market Value on 1.4.2001	3,60,000	26,00,000
Cost of Additional Construction (2014-15)	3,20,000	10,50,000
Sale Price (Jan 2024)	12,50,000	99,50,000
Selling Expenses	30,000	55,000

### Solution 6.1.6

#### Computation of Capital Gains for the Year 2023-24

##### House I

Full value of consideration:	12,50,000
Less: Selling expenses:	30,000
	<u>12,20,000</u>

Less: Indexed cost of acquisition: $(₹3,60,000 / 100) \times 11,91,600$	331	11,91,600
Less: Indexed cost of improvement: $(₹3,20,000 / 220) \times 331$	4,81,454	16,73,054
Long-term capital loss		<u>4,53,055</u>

##### House II

Full value of consideration	9,95,00,000
Less: Selling expenses	55,000
	<u>9,94,45,000</u>
Less: Indexed cost of acquisition: $(₹26,00,000 / 100) \times 331$	86,06,000
Less: Indexed cost of improvement: $(₹10,50,000 / 220) \times 331$	15,79,773
	<u>1,18,05,227</u>
Net long term capital gain 11805227-453055	<u>11352172</u>

### Illustration 6.1.7

Mr. Jack, a German citizen, resident and ordinarily resident in India, had a house in Singapore, purchased in 1990 at a cost of 2, 00,000. In June 1998 Mr. Albert, son of Mr. Jack, (Resident and ordinarily resident in India) got the house as per a will duly executed. In December 2005, Mr. Albert re-modelled the house and constructed an upper floor at a cost of 10, 00,000.

In January 2023 Mr. Albert sold the house for 95,40,000. Selling expenses 40,000.

Compute the taxable capital gain if any, for the year 2022-23, assuming that the fair market value of the house on 1.4.2001 was 15,20,000 and in June 1998 ₹8,00,000.

Cost inflation index: 2001-02-100, 2005-06-117, 2022-23-331.

### Solution 6.1.7

#### Computation of capital gains

Full value of consideration	95,40,000
Less: Selling expenses	40,000
	<u>950000</u>
Less: Indexed cost of acquisition to the previous owner or Indexed FMV on 1.4.2001 (15,20,000/100) x 331	5031200
Less: Indexed cost of improvement (10,00,000/117) x 331	2829060
	<u>7860260</u>
Long term capital gain	1639740

\* Indexed from the year in which the previous owner acquired the asset or FMV on 1.4.2001 whichever is higher.

### Illustration 6.1.8

Mr. Ashok purchased 200 equity shares of A Ltd. on 1.1.2004 at a cost of 60 per share. In 2008-09 he got 100 bonus shares from the company. In addition, he obtained 800 rights shares at the same price in December 2013. During the year 2022-23, he sold the entire shares at the rate of 430 per share. Compute capital gain to be included in the total income under section 112A assuming that the brokerage and selling expenses were 5,000. The market value of the share on 1.4.2001 was 80 per share and on 31.1.2018 320. Cost inflation indexes: 2001-02-100, 2004-05-113, 2008-09-137, 2013-14-220, 2022-23-331.

### Solution 6.1.8

#### Computation of capital gain

Full value of consideration (430 x 1,100)	473000
Less selling expense	5000
	<u>468000</u>
Less cost of acquisition (320 x 1100)	352000
Long term capital gain	116000
Less long-term capital gain not taxable	100000
Capital gain to be included in total income	16000

### Illustration 6.1.9

Shereena gifted 400 grams of gold ornaments and a car to her daughter Aileen, on the occasion of marriage. Shereena purchased the jewellery in 1970 at the rate of 150 per gram and car for ₹3, 00,000 in 1995. Aileen sold half of the ornaments in June 2022 at the rate of ₹ 5,000 per gram and purchased a plot of land, using the amount.

In January 2023, Aileen spent 50,000 for the major repairs of the car and sold the car for 1, 50,000 and purchased a new car for ₹7, 00,000.

Compute capital gain and tax payable on capital gain, assuming that the market value of the gold on 1.4.2001 was 800 per gram. Aileen has other income exceeding the non-taxable limit.

Cost Inflation Index: 2001-02-100, 2022-23-331.

### Solution 6.1.9

#### Computation of capital gain

Full value of consideration (200 x 5,000)	1000000
Less: Indexed cost $[(200 \times 800)/100] \times 331$	529600
Long term capital gain	470400
Tax on long capital gain (20% plus 4% HEC)	97843

### Recap

- ◊ Profit - generated when a capital asset is sold or transferred
- ◊ Capital asset -t held by an assessee for not more than 36 months immediately preceding the date of its transfer
- ◊ Transfer of capital asset -the process by which ownership or rights over a capital asset are shifted
- ◊ Full value -the whole price without any deduction whatsoever
- ◊ Cost of acquisition of an asset -the value for which it is acquired by the assessee.
- ◊ Selling expense - commission to brokers, registration fee paid by the assessee, advertisement expenses
- ◊ the expenditure incurred to increase the value of a capital asset- Improvement

## Objective Questions

1. What is the profit generated when a capital asset is sold or transferred?
2. What type of capital asset is held by an assessee for not more than 36 months before its transfer?
3. What is the process of shifting ownership or rights over a capital asset from one party to another?
4. What does "full value" mean in the context of capital gains?
5. What refers to the value for which an asset is acquired by the assessee?
6. What expenses can be deducted from the full value of consideration to ascertain the capital gain?
7. What is the term for the expenditure to increase the value of a capital asset?

## Answers

1. Capital gain
2. Short-term
3. Transfer
4. Price
5. Acquisition
6. Selling expenses
7. Improvement

## Assignments

1. Define and explain the cost of acquisition with an example.
2. What is cost of improvement? Provide two real-life examples of such expenses.
3. A person buys land for ₹10 lakhs, spends ₹2 lakhs on improvement, and sells it for ₹20 lakhs. Calculate the capital gain assuming selling expenses of ₹50,000.

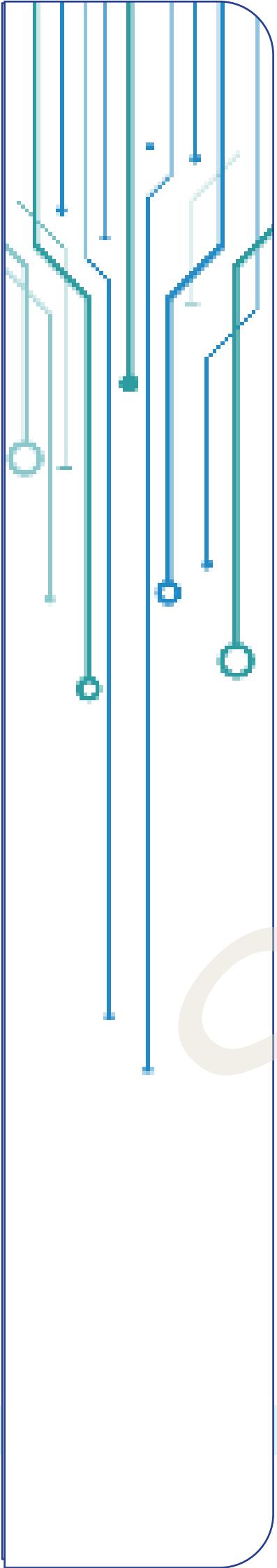
4. Create your own scenario involving the sale of a capital asset. Identify and calculate the components of capital gain using hypothetical values.
5. Explain the basis of charge for capital gains under the Income Tax Act. Provide an example.
6. Define capital assets with suitable examples. How are they different from personal effects?
7. Differentiate between short-term and long-term capital assets with examples.
8. Discuss the meaning and types of transfer in relation to capital assets.
9. Explain the steps involved in the computation of capital gains.
10. What is full value of consideration? How does it impact capital gain calculation?

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# Unit Capital Gains

## Exempt from Tax

### Learning Outcomes

After completing this unit, the learner should be able to;

- ◊ get an awareness on the concept of exempt capital gains.
- ◊ apply exemption provisions to practical scenarios
- ◊ evaluate eligibility criteria for exemptions

### Prerequisites

When a person sells a long-term capital asset like a residential property, the profit earned is treated as a long-term capital gain (LTCG) and is usually taxed at 20%. However, under certain conditions, this tax can be completely avoided through exemptions provided in the Income Tax Act. Consider a scenario where someone bought a house more than a decade ago for ₹25 lakhs. Over time, the value of the property increased significantly. In 2024, they sold the property for ₹80 lakhs. After accounting for the indexed cost of acquisition, this resulted in a long-term capital gain of ₹35 lakhs. Under normal tax rules, this gain would be subject to a 20% tax, resulting in a liability of ₹7 lakhs. However, the Income Tax Act offers relief under Section 54, which provides an exemption if the capital gain from the sale of a residential property is reinvested in another residential property within a specified period—either within 2 years after the sale or 1 year before it, or if a new house is constructed within 3 years. In this case, the seller reinvested the entire ₹35 lakhs in purchasing another residential flat within six months of the sale. Since the full amount of capital gain was used for the new purchase and the investment met the time-frame and property criteria specified in Section 54, the entire capital gain became tax-exempt. Under income tax laws, taxpayers are entitled to numerous exemptions.

## Keywords

capital gain, tax exemptions

## Discussion

Any profits or gains arising from the transfer of the following assets are exempt from tax, i.e., they will not be included in the income of the assessee for tax purposes:

### 6.2.1 Capital gains in case of Liquidation of Companies (Sec. 46(1))

Where the assets in specie of a company are distributed to its registered shareholders on its liquidation, such a distribution is not regarded as a transfer of a capital asset by the company for purposes of taxation.

### 6.2.2 Capital gains arising on the transfer of property used for residence (Sec. 54)

Capital gains arising on the transfer of buildings or lands appurtenant thereto, and being a residential house, are exempt subject to the following conditions:

- i. The building is owned by an individual or Hindu Undivided Family.
- ii. Such property was being used as a residential house.
- iii. The income of such house property is chargeable under the head 'Income from House Property'.
- iv. The exemption will be available only in relation to a house property which had been held by the taxpayer for a period exceeding 24 months before transfer.
- v. The assessee has, within a period of one year before or two years after the date of transfer, purchased one residential house in India, or he has, within a period of three years after the date of transfer, constructed one residential house in India. Here, the term 'constructed' means completed.

Where a part of the capital gain is appropriated towards the purchase of a plot and a part towards the construction of a residential house thereon, the aggregate cost shall be considered for exemption u/s 54, provided the acquisition of the plot and the construction thereon are completed within the aforesaid period.

Where an assessee starts the construction of a new building before the sale but completes it after the sale of the old building, the assessee is entitled to exemption.

Allotment of a flat under the self-financing scheme of the Delhi Development Authority is treated as construction of a house for this purpose.

Two flats were acquired under different agreements, but the map of the general layout plan and internal layout plan indicated that there was only one common kitchen for both flats, and both flats were used as a single unit. Flats were constructed in such a way that adjacent units or flats could be combined into one. Thus, the two flats were a single unit and house for the purpose of resident claim u/s 54 could not be denied.

Section 54 benefit is available even if the sold flat was constructed on land occupied by the housing society on a leasehold basis.

The date of allotment of a flat by DDA would be the date of purchase for computing capital gains tax.

### **Amount of exemption**

- i. The capital gains arising from the transfer of such residential house are exempt to the extent of the cost of the new residential house purchased or constructed within the specified period, or ₹ 10 crore, whichever is lower. This means if the whole capital gain is reinvested in the cost of the new house, it is fully exempt from tax. If only a part of it is reinvested, the balance of it is chargeable to tax. Where the amount of capital gain is spent partly on the purchase of house property and partly on further construction of it, exemption is available in respect of both amounts.
- ii. Where the amount of capital gain is not utilised by the assessee for acquisition of a new house before the due date for furnishing the return of income u/s 139, 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, with a specified bank authorised by the Central Government in accordance with the Scheme; he will be entitled to exemption.

### **Withdrawal of exemption and tax on sale of the new house**

The new house (purchased or constructed) should not be transferred within a period of three years of its purchase or construction. If it is transferred within three years, the exemption given earlier will be withdrawn, and the old exempted capital gains and new capital gains (if any) arising on the transfer of the new residential house shall be chargeable to tax as the income of the previous year in which the new residential house is transferred.

If instead of a capital gain, there is a capital loss on the transfer of the new residential house, it shall be deducted from the exempted capital gains of the old house, and the balance, if any, shall be capital gain of the previous year in which the new house is transferred.

### **Tax on the unutilised amount**

If the amount deposited is not utilised fully for acquiring the new house within the period stipulated (i.e., 3 years from the date of transfer of the original house), the amount not so utilised shall be treated as the long-term capital gain of the previous year in which the specified period expires. The taxpayer shall be entitled to withdraw such amount in accordance with the scheme.

### **6.2.3 Capital gains arising from the transfer of agricultural land (Sec 54B)**

Any capital gain arising on the transfer of agricultural land situated in an urban area is exempt, subject to the following conditions:

- i. The agricultural land is owned by an individual or a HUF.
- ii. The agricultural land was, in the two years immediately preceding the date of transfer, being used either by the assessee or his parent or a HUF (as owner or otherwise) for agricultural purposes.
- iii. The assessee has purchased, within a period of two years from the date of transfer (and not before sale), any other land for agricultural purposes.

#### **Amount of exemption**

- i. The capital gain arising from the transfer of such agricultural land is exempt to the extent of the cost of the new agricultural land purchased within two years from the date of transfer. This means that if the whole capital gain is reinvested, it is fully exempt from tax. If only a part of it is reinvested, the balance is chargeable to tax.
- ii. If the amount of capital gains is not utilised by the assessee for the 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 for furnishing the return of income in an account opened under the Capital Gains Account Scheme, 1988, and utilised in accordance with the scheme. The amount already utilised for reinvestment, together with the amount of deposits, shall be exempt from tax.

#### **Withdrawal of exemption and tax on sale of new asset**

If this new land is transferred within three years of its purchase, the exemption given earlier will be withdrawn, and the capital gains arising from the transfer of the new land, together with the exempted capital gains of the old land, shall be the chargeable capital gains of the previous year in which the new land is transferred.

#### **Tax on the unutilised amount**

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 capital gains of the previous year in which the period of two years from the date of transfer of the original agricultural land expires. Further, the taxpayer will be entitled to withdraw such amount in accordance with the scheme.

The effect of the new scheme for deposits is that if the assessee cannot utilise the capital gains for the acquisition of new agricultural land on or before the due date for furnishing the return of income, he may deposit it under this scheme up to the due date for furnishing the return of income in order to avail himself of this exemption. After such deposit, he must utilise the deposit for acquiring new agricultural land within two years from the date of transfer of the old agricultural land.

Capital gains on the transfer of agricultural land situated in an urban area shall be exempt if the following conditions are satisfied.

- The owner of the agricultural land is an individual or a HUF.
- It was, in the two years immediately preceding the date of transfer, being used by the HUF, individual, or his parent.
- The transfer of land is by way of compulsory acquisition under any law, or a transfer the consideration for which is determined by the Central Government or the R.B.I.

#### **6.2.4 Capital gains on compulsory acquisition of land and buildings**

Capital gains arising on the transfer, by way of compulsory acquisition under any law, of land or building are exempt subject to the following conditions:

- i. The land or building should be used by the assessee for the purpose of an industrial undertaking.
- ii. The assessee has used this land or building for the purpose of the business of the industrial undertaking for at least two years immediately preceding the date on which the transfer took place.
- iii. The assessee has, within a period of three years after such transfer, purchased any other land or building or constructed any other building for the purpose of shifting or re-establishing the industrial undertaking or setting up another industrial undertaking in that building.

##### **Amount of exemption**

- i. If the amount of capital gains is less than or equal to the cost of new land or building, the entire amount of capital gains will be exempt from tax. If the amount of capital gains exceeds the cost of acquisition or construction, only the excess shall be chargeable to tax.
- ii. If the amount of the capital gain is not utilised by the assessee for the purchase or construction of the new land and building before the due 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 in an account opened under the Capital Gains Account Scheme, 1988, and utilised in accordance with the scheme. The amount already utilised for reinvestment, together with the amount of deposits, shall be exempt from tax.

#### **6.2.5 Capital gain arising from the transfer of a long-term capital asset invested in long-term specified assets (Sec. 54EC):**

Where an assessee transfers a long-term capital asset (original asset) and invests the capital gain in the long-term specified assets (new asset), the assessee shall be entitled to exemption as per the following conditions.

1. The new asset should be purchased within six months from the date of transfer of the original asset.
2. If the cost of the new asset is not less than the amount of capital gains, the whole capital gains shall be exempt. If it is less, the amount invested shall be exempt.
3. Where the new asset is transferred or converted into money within three years from the date of acquisition, the exempted amount of capital gains shall be chargeable to tax as long-term capital gains of the previous year in which the new asset is transferred.
4. Where the assessee has claimed exemption in respect of the new asset under this section on such cost, he will not be entitled to deduction under section 80C.

#### **Maximum investment in specified asset:**

The investment made in the long-term specified asset by an assessee during the financial year in which the original asset is transferred and in the subsequent financial year shall not exceed 50 lakh.

#### **6.2.6 Capital gains arising from the transfer of a long-term capital asset invested in units of a specified fund.**

Provisions of this section are the same as discussed in Sec. 54EC, except the asset in which LTCG should be invested. Asset for investment:

A unit or units, issued before 1.4.2019, of such fund as may be notified by the Central Government in this behalf.

#### **6.2.7 Exemption from tax on long-term capital gains on investment of the consideration in a residential house**

Long-term capital gains are exempt under this section if the following conditions are satisfied:

- i. The assessee is either an individual or a Hindu Undivided Family.
- ii. The assessee has transferred a long-term capital asset which is not a residential house.
- iii. The assessee does not own more than one residential house on the date of transfer of the original assets other than as mentioned in (iv) below.
- iv. The taxpayer purchases, within a year before or within two years after the date on which the transfer took place, or constructs within a period of three years after the date of transfer, one residential house in India. Construction means completion. Allotment of a flat under the self-financing scheme of the Delhi Development Authority is treated as construction of the house for this purpose.
- v. The income from the newly acquired residential house is chargeable under the head 'Income from House Property.'

Co-ownership in a second house does not lead to denial of section 54F exemption.

## **6.2.8 Exemption of capital gains on transfer of assets in the case of shifting of industrial undertakings from the urban area**

Capital gains on the shifting of an industrial undertaking from an urban area to a non-urban area are exempt if the following conditions are satisfied:

- a. The assessee transfers a long-term or short-term capital asset in the nature of plant, machinery, building, or land.
- b. Such asset should have been used for the purpose of the business of the industrial undertaking situated in the urban area.
- c. The asset should have been transferred in connection with the shifting of the undertaking to a non-urban area.
- d. The amount of capital gains should be utilised by the assessee within a period of one year before or three years after the date of transfer for the following purposes:
  1. purchasing new machinery or plant and/or acquiring land or a building or constructing a building for the purpose of his business in the area to which the undertaking is shifted,
  2. shifting the original asset and transferring the establishment of the undertaking to such area, and
  3. incurring expenses on such other purposes as may be specified in a scheme framed by the Central Government.
- e. The newly acquired machinery or plant or land or building must be held by the assessee for three years from the date of their acquisition.

Advances paid for the purpose of purchase and/or acquisition of plant/machinery and land/building amount to utilisation by the assessee of capital gains u/s 54G.

## **6.2.9 Capital gains on shifting of industrial undertaking from urban area to any Special Economic Zone**

Capital gains on the shifting of an industrial undertaking from an urban area to any Special Economic Zone are exempt if the following conditions are satisfied:

1. The assessee transfers a long-term or short-term capital asset in the nature of plant, machinery, building, or land or any right in a building or land.  
Exemption is not available on capital gains on the transfer of other assets like furniture.
2. Such asset must be used for the purposes of the business of the industrial undertaking situated in the urban area.
3. The asset must be transferred in connection with the shifting of the undertaking to any Special Economic Zone, developed in any urban area or any other area.

4. The amount of capital gains should be utilised within a period of one year before or three years after the date of transfer for the following purposes:
  - i. Purchase of machinery or plant, acquisition of land or building, or construction of a building for the purposes of business in the Special Economic Zone.
  - ii. Expenses on shifting the original asset and transferring the establishment of the undertaking to the Special Economic Zone.
  - iii. Expenses on such other purposes as may be specified in a scheme framed by the Central Government.

Where the amount of capital gain is not appropriated or utilised by the assessee for the above purposes before the due date for furnishing a return u/s 139(1), it shall be deposited on or before the due date of furnishing the return of income in the Capital Gains Accounts Scheme, 1988, and utilised in accordance with the scheme. The amount already utilised for the purposes aforesaid, together with the amount so deposited, shall be deemed to be the amount utilised for the new asset.

## 6.2.10 Exemption of long-term capital gains on transfer of residential property

Who is entitled to exemption?

An individual or a Hindu Undivided Family.

Asset transferred:

A long-term capital asset being a residential property (a house or a plot of land), which should be transferred before 1.4.2017 or, in the case of an eligible start-up, before 1.4.2022.

Conditions for exemption:

The assessee utilises the net consideration for subscription in equity shares of an eligible company before the due date of furnishing the return of income u/s 139(1).

If he invests less than the net consideration in equity shares, the proportionate capital gain shall be exempt.

1. The company utilises the money within one year from the date of subscription in equity shares by the assessee for the purchase of a new asset being plant and machinery.
2. In the case of an eligible start-up, being a technology-driven start-up, the new asset shall also include computers or computer software.
3. If the company does not utilise the consideration received from the issue of shares to the assessee for the purchase of new plant or machinery before the due date of furnishing the return of income by the assessee, the consideration not so utilised shall be deposited in specified banks or institutions in a notified scheme.
4. The profit of the deposit in point (3) shall be enclosed with the return of income of the assessee.

Withdrawal of exemption.

1. If the amount deposited in the specified bank, etc., is not utilised within the period mentioned in (2) by the company, the proportionate capital gains shall be chargeable to tax for the assessee of the previous year in which the period of one year from the date of the subscription in equity shares by the assessee expires.
2. If the assessee sells or otherwise transfers the shares, or the company sells or otherwise transfers the new plant or machinery within five years (or computer or computer software) within three years from the date of acquisition, the exempted capital gains shall be deemed to be the capital gains of the previous year in which the shares, new plant, machinery, or computer or computer software are transferred or sold.
3. If there are gains on the transfer of shares to the assessee, they shall be chargeable to tax in his hands.
4. If there are gains on the transfer of plant or machinery to the company, the company shall be liable to pay tax on it.

#### Eligible Company

It means a company that fulfils the following conditions:

- i. It is a company incorporated in India during the period from 1st April of the previous year relevant to the assessment year in which capital gains arise to the due date of furnishing the return of income u/s 139(1).
- ii. It is engaged in the business of the manufacture of an article or thing or in an eligible business.
- iii. It is a company in which the assessee has more than 25% share capital or more than 25% voting rights after the subscription in shares by him.
- iv. It is a company that qualifies to be a small or medium enterprise or eligible start-up.

#### Illustration 6.2.1

From the following information of Mr Saran compute the chargeable capital gains:

(a)	(i) Cost of acquisition of residential house in 2001-02	500000
	(ii) Sale consideration on 2.6.2023	3600000
	(iii) Cost of new house purchased for residential purpose by due date of filing the return	1100000

The cost inflation index in 2001-02 was 100 and in 2023-24 it was 348.

(b) Would it make any difference if the assessee deposits ₹ 8,00,000 in Capital Gains Account Scheme by the due date of filing the return for the Assessment Year 2024-25 but does not utilise the amount for acquisition of residential house before 2.6.2026.

### Solution 6.2.1

#### (a) Computation of Capital Gain (for the Assessment Year 2024-25)

Sale consideration	3600000
Less: Indexed cost of acquisition ( $5,00,000 \times 348 \div 100$ )	1740000
	1860000
Less: Cost of new house	1100000
Taxable capital gain	760000

#### (b) Computation of Taxable Capital Gain (for the Assessment Year 2024-25)

Sale consideration	36,00,000
Less Indexed cost of acquisition	17,40,000
	18,60,000
Less: Exemption u/s 54 regarding deposit under Capital Gains Account Scheme, 1988	800000
Taxable Capital Gain	10,60,000

### Illustration 6.2.2

Mr. George had been living in a house which he purchased in 2001-02 for ₹ 4,00,000. The house was acquired by the Government in July 2023 and compensation of ₹ 25,00,000 was paid to him. He purchased a residential house in Feb, 2023 at 15,00,000. The additional compensation of 70,000 will be given to him in March, 2025. If he sells the new residential house in October, 2024 at 16,00,000, compute the amount of capital gains, chargeable to tax for the Assessment Years 2024-25 and 2025-26. The cost inflation index in 2001-02 was 100 and in 2023-24 it was 348.

### Solution 6.2.2

#### Computation of Taxable Capital Gains (for the Assessment Year 2024-25)

Compensation received	2500000
Less Indexed cost of the house ( $4,00,000 \times 348 \div 100$ )	1392000
	1108000
Cost of the new house purchased in February, 2023	1500000
Capital gain chargeable to tax-Nil, as the cost of new house is more than the amount of capital gain.	

### Computation of Taxable Capital Gains (for the assessment year 2025-26)

Selling price of the new house	1600000
Less: Cost of the new house purchased in February 2023 (₹15,00,000- ₹ 11,08,000 Capital Gains)	392000
Short-term Capital Gains	1208000
Additional Compensation	70000
Taxable Capital Gain	1278000

### Illustration 6.2.3

During the year ended 31st March 2004 Mr Arun sold the following assets.

Particulars	Sale proceed
(i) Shop purchased in 2006-07 (C.I.I. 122) for 36,600	150000
?(ii) Machinery purchased in 2015-16 (C.I.I.:250 for ₹ 50,000 (W.D.V on 1.4.2003 ₹ 35,000)	60000
(iii) Furniture purchased on 1.5.2023 for ₹ 1,000	1300
(iv) Machinery purchased on 1.5.2023 ₹ 10,000	12000
(v) Agricultural land in Haryana purchased in 1999-2000 for ₹10,000 (F.M.V. on 1.4.2001 (C.I.I-100) being ₹ 15,000)	260000
(vi) One residential house purchased in 2008-09/C.I.I. :137) costing ₹ 41,100	300000

During the year he bought another house for his residence for ₹ 250000

Compute the amount of capital gains to be included in the gross total income and also compute his total income during the year was 220000. Cost of inflation index for 2023-24 is 348.

### Solution 6.2.3

#### Computation of Capital Gains (for the Assessment Year 2024-25)

(i) Shop	
Sale Proceeds	150000
Less: Indexed cost of acquisition $(36,600 \times 348 \div 122)$	104400
Long term capital gain	45600
(ii) Machinery	35000
W.D.V. on 1.4.2023	
Add: Purchased during the year	10000

Sale Proceeds (₹60,000+12,000)	72000
Short term capital gain	27000
(iii) Furniture	
Sale Proceeds	1300
Less: Cost	1000
Short term capital gain	300
Agricultural Land	
Sales	260000
Less Indexed cost of acquisition F.M.V. on 1.4.2001 (15,000 × 348÷100)	552000
Long term capital gain	207800
Residential House	
Sales Proceeds	300000
Less: Indexed cost of acquisition (41,100x348÷137)	104400
Capital gains	195600
Since cost of new residential house purchased during the year is more than the capital gain, the whole amount of capital gain is exempt from tax	

#### Taxable Capital Gains(for the Assessment Year 2024-25)

1. L.T.C.G. on shop	45600
2. L.T.C.G. on Agricultural Land	207800
3 S.T.C.G. on Machinery	27000
4 S.T.C.G. on Furniture	300
	<b>Taxable capital gains</b>
	<b>280700</b>

#### Statement of total income

1. Business Income	220000
2. Capital Gains	280700
	<b>Gross total income</b>
	<b>500700</b>
Less: Deduction	nil
	<b>Total income</b>
	<b>500700</b>

## Recap

- ◊ (Sec. 54)-Capital gains arising on the transfer of property used for residence
- ◊ Co-ownership in second house- does not lead to denial of section 54F exemption
- ◊ (Sec. 54EC) - Capital gain arising from transfer of a long-term capital asset invested in long-term specified asset --
- ◊ Capital Gains Accounts Scheme, 1988
- ◊ (Sec 54B) - Capital gains arising from the transfer of agricultural land

## Objective Questions

1. Which section provides exemption on capital gains arising from the sale of a residential house if the gains are reinvested in another residential house
2. What is the maximum amount that can be invested in bonds under Section 54EC in a financial year?
3. Under which section is exemption available for capital gains arising from the transfer of agricultural land used by the assessee?
4. What is the minimum holding period for capital gains to be considered long-term for land or building?
5. Capital gains arising due to liquidation of a company are covered under which section?
6. Which section allows exemption on reinvestment of capital gains in a residential house when the original asset sold was not a house?
7. What is the lock-in period for bonds purchased under Section 54EC?

## Answers

1. Section 54
2. ₹50 lakhs
3. Section 54B
4. 24 months
5. Section 46(1)
6. Section 54F
7. 5 years

## Assignments

1. Prepare a case study of a taxpayer claiming exemption under Section 54.
2. Illustrate the calculation of capital gains and its exemption using a hypothetical example under Sec. 54F.
3. Describe the investment options available under Section 54EC.
4. Collect real-life cases or judgments related to exemption under Section 54B.
5. Prepare a comparative report on exemptions available for individual vs. company taxpayers.
6. What are the conditions required to claim exemption under Section 54 of the Income Tax Act?
7. Explain the applicability of Section 54B for capital gains from agricultural land.
8. What is the time period allowed for reinvestment under Section 54EC?
9. How is capital gain treated in the event of liquidation of a company under Section 46(1)?
10. Describe the exemption available on compulsory acquisition of land and building.
11. What are "long-term specified assets" under Section 54EC?
12. How does Section 54G benefit industries shifting from urban areas?

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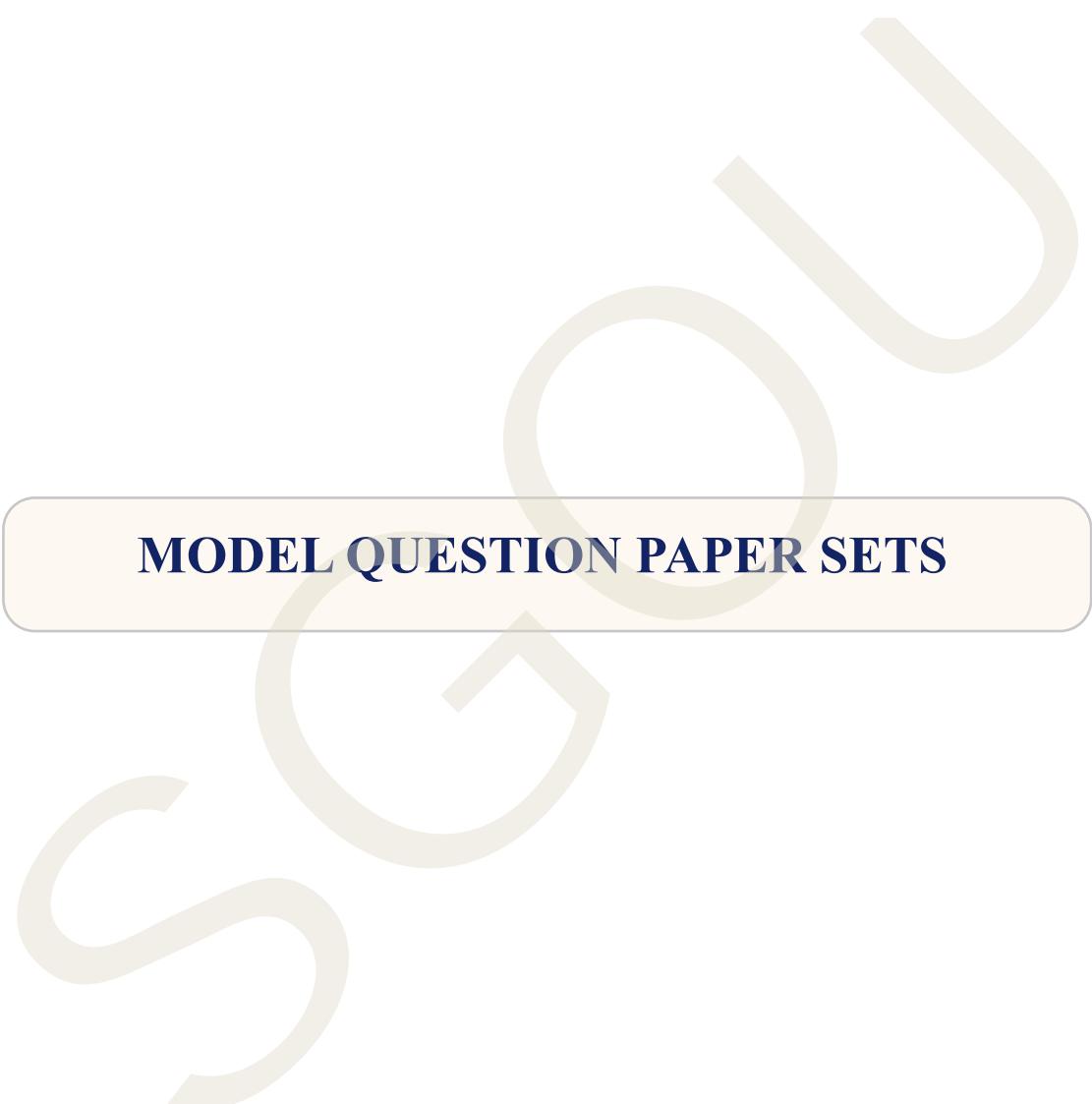
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## Suggested Reading

1. Bhattacharya, A. (2023). Indian income tax law and practice. Cengage Learning India.
2. Lakhotia, R. N. (2022). How to save income tax through tax planning. Vision Books.
3. Singhania, V. K. (2023). Direct taxes ready reckoner. Taxmann Publications.





**MODEL QUESTION PAPER SETS**



## SREENARAYANAGURU OPEN UNIVERSITY

QP CODE: .....

Reg. No : .....

Name : .....

### Model Question Paper- Set-I

#### FOURTH SEMESTER BACHELOR OF COMMERCE EXAMINATION DISCIPLINE CORE COURSE **B21CM07DC- Income Tax I**

(CBCS - UG)  
2022-23 - Admission Onwards

Time: 3 Hours

Max Marks: 70

#### SECTION A

**I Answer any 10 questions. Each question carries 1 mark**

1. What is the income exemption threshold for a minor child?
2. The actual amount of rent receivable from the tenant is known as?
3. What are different types of residents?
4. Which Section of Income tax Act gives the basis of charge for house property income?
5. What is the process of shifting ownership or rights over a capital asset from one party to another?
6. Fund which are not recognised by the Commissioner of Income Tax is known as.
7. Who introduced the first income tax in India and in what year?
8. What is the profit generated when a capital asset is sold or transferred?
9. State how the interest credit on employee's contribution to UPF is treated
10. What is called location of the leader's position and governing authority?
11. In which economic activity is the employee's intellectual skills used?
12. A domestic company whose shares are not publicly listed on a recognised exchange is referred to as what?
13. The rent fixed by the Rent Control Act is known as?
14. Could you explain what it means for someone to be taxed in the same year that they earn money?
15. What type of capital asset is held by an assessee for not more than 36 months before its transfer?

**(10 X 1=10 marks)**

## SECTION B

### II Answer any 10 questions. Each question carries 2 marks

16. Define income tax?
17. What is assessment year?
18. The following are the incomes of Mr. Y. Compute the Gross Total Income of Mr. Y if he is
  - (i) Ordinarily Resident,
  - (ii) Not Ordinarily Resident, and
  - (iii) Non-Resident
    - Profit earned from business in Mumbai ₹6,000
    - Income from house property in Canada, received in India ₹3,000
    - Profit from business in Canada, received in India ₹9,000
    - Income from profession as a software consultant in Singapore, received there. The profession set up in India ₹12,000
    - Pension from former employer in India, but received in UAE ₹5,000
19. What are the components of salary?
20. Write a short note on full value consideration?
21. What is composite rent?
22. State any two conditions required to claim exemption under Section 54?
23. State the difference between total income and gross total income
24. Define Gross Annual Value (GAV) of a house property? Define Gross Annual Value (GAV) of a house property?
25. Given below is the Profit and Loss Account of Mr. Rohan, a hardware merchant, for the year ended 31st March, 2024. Compute his Total Income for the Assessment Year 2024–25

*Profit and Loss Account (For the year ended 31st March, 2024)*

Particulars	Amount	Particulars	Amount
Opening Stock	40,000	Sales	7,20,000
Purchases	3,60,000	Rent from House Property	20,000
Wages	1,20,000	Closing Stock	50,000
Audit Fees	2,000		
Repairs (House Property)	3,000		
General Charges	2,500		
Commission for Raising Loan	1,500		
Bad Debts Reserve	1,200		
Bad Debts	3,000		
Interest on Capital	12,000		
Contribution to Employee Welfare Fund	3,000		
Provision for Income Tax	2,500		
Depreciation (Allowable)	4,000		
<b>Net Profit</b>	<b>2,35,800</b>		
<b>Total</b>	<b>7,84,000</b>	<b>Total</b>	<b>7,84,000</b>

**(10X2=20 marks)**

## SECTION C

### III Answer any 5 questions. Each question carries 4 marks

26. Mr. Aswin purchased 200 equity shares of A Ltd. on 1.1.2004 at a cost of 60 per share. In 2008-09 he got 100 bonus shares from the company. In addition, he obtained 800 rights shares at the same price in December 2013. During the year 2022-23, he sold the entire shares at the rate of 430 per share. Compute capital gain to be included in the total income under section 112A assuming that the brokerage and selling expenses were 5,000. The market value of the share on 1.4.2001 was 80 per share and on 31.1.2018 320. Cost inflation indexes: 2001-02-100, 2004-05-113, 2008-09-137, 2013-14-220, 2022-23-331.

27. Y Ltd. Provided the following perquisites to its employee Mr. F for the PY 2024-25:

- ◊ Accommodation taken on lease by Y Ltd. for Rs. 15000 pm. Rs. 5000 pm is recovered from the salary of Mr. F.
- ◊ Furniture for which the hire charges paid by Y Ltd. is 3000 pm. No amount is recovered from the employee in respect of the same.

28. State, giving brief reasons, whether the following items are allowable while computing profits and gains of business or profession:

- i. Donation to a political party.
- ii. Fees paid to the lawyer for drafting a new Partnership Deed.
- iii. Sums paid to a labour leader to call off the strike.
- iv. Salary paid to son, who is working in the office. The salary is reasonable.
- v. Rent paid to daughter for office block which was gifted to her at the time of her marriage.

29. Mr. Rajan, an Indian citizen, visited India during the previous year 2024-25 for a family function. He arrived in India on 1st August 2024 and stayed until 31st December 2024. During the four years preceding 2024-25, his stay in India was as follows:

- ◊ 2020-21: 110 days
- ◊ 2021-22: 90 days
- ◊ 2022-23: 100 days
- ◊ 2023-24: 80 days

His total income (excluding income from foreign sources) for the previous year 2024-25 is ₹18,00,000.

Determine the residential status of Mr. Rajan for the assessment year 2025-26 with reasons.

30. Explain the concept of "Annual Value" under the head Income from House Property. How is it determined for a self-occupied and a let-out property?

31. What is meant by capital gains under the Income Tax Act? Differentiate between short-term and long-term capital gains with examples.

32. Brief note on any five expenses that are allowed as deductions while computing income under the head Profits and Gains of Business or Profession.

33. Mr. Raghavan owns a house property in Chennai which is let out. The following details are available for the previous year 2024–25:

- ◊ Municipal value: ₹1,80,000
- ◊ Fair rent: ₹2,00,000
- ◊ Standard rent: ₹1,90,000
- ◊ Actual rent received: ₹2,10,000
- ◊ Municipal taxes paid by the owner: ₹30,000
- ◊ Interest on home loan: ₹40,000

Compute the income from house property for the Assessment Year 2025–26.

- ◊ A car of 1200 cc which is owned by Y Ltd. and given to Mr. F to be used for both official
- ◊ and personal purposes. All running and maintenance expenses are fully met by the
- ◊ employer. He is also provided with a chauffeur.

Compute the value of perquisites chargeable to tax for the AY 2025-26, assuming his salary for perquisite valuation is Rs. 10 lakhs.

**(5X4=20 marks)**

#### **SECTION D**

#### **IV Answer any 2 questions. Each question carries 10 marks**

34. Compute the income from salary of Mr. X from the following particulars for the year ended 31.03.2025:

- ◊ He retired on 31.12.2024 at the age of 60, after 25 years and 9 months of service from a private company at Kochi.
- ◊ He was paid a salary of Rs.25000 pm and house rent allowance of Rs.6000 pm. He paid rent of Rs.6500 pm, during his tenure of service.
- ◊ On retirement, he was paid a gratuity of Rs.350000. He was covered by the payment of Gratuity Act, 1972. He had not received any other gratuity at any point of time earlier, other than this gratuity.
- ◊ He had accumulated leave of 15 days per annum during the period of his service; this was encashed by him at the time of his retirement. A sum of Rs.315000 was received by him in this regard. Employer allowed 30 days leave per annum
- ◊ He is receiving Rs.5000 as pension. On 1.2.2025, he commuted 60% of his pension and received Rs.300000 as commuted pension.

- ◊ The company presented him with a gift voucher of Rs.5000 on the retirement. His colleagues also gifted him a mobile phone worth Rs.50000 from their own contribution.

35. Compute the gross total income of Mr Shanaaz if he is Ordinarily resident, Not ordinarily resident or Non resident.

- ◊ Profit of a hotel business at China Rs 15,000
- ◊ Royalty received in Singapore from a resident of India for technical services provided for a
- ◊ business carried on in Singapore Rs 10,000.
- ◊ Interest on Bonds issued by Government of Japan received and spent there Rs 12,000
- ◊ Income from house property situated in Nepal, received there Rs 17,000.
- ◊ Profit from business in Bhutan, deposited in a bank there, Rs 10,000
- ◊ Profit on sale of a building in India but received in Bhutan, Rs 13,000.

36. Essay on history of Income tax in India.

37. Shaji owns a furniture manufacturing business. During the financial year, he:

- ◊ Purchased machinery worth ₹10,00,000 on October 1st
- ◊ Paid ₹3,00,000 as salary to employees
- ◊ Incurred ₹50,000 on business travel
- ◊ Paid a penalty of ₹30,000 for violating environmental laws
- ◊ Paid ₹1,00,000 for a new office building
- ◊ Donated ₹25,000 to a political party

- a. Compute the depreciation allowable for the machinery.
- b. Identify allowable and disallowable expenses under PGBP.
- c. Calculate the taxable business income if Ravi's total revenue is ₹20,00,000.

**(2X10=20 marks)**



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### Model Question Paper- Set-II

#### FOURTH SEMESTER BACHELOR OF COMMERCE EXAMINATION DISCIPLINE CORE COURSE **B21CM07DC- Income Tax I**

(CBCS - UG)  
2022-23 - Admission Onwards

Time: 3 Hours

Max Marks: 70

#### SECTION A

**I Answer any 10 questions. Each question carries 1 mark**

1. How a business pays out its earnings to its stockholders?
2. Who approves the Finance Act?
3. Allowance disbursed to employees to offset the increase in price levels is known as?
4. What is the percentage limit for exempting partial withdrawals from the National Pension System Trust?
5. State the amount of interest credited on employee's contribution to RPF which is taxable.
6. Who levies taxes in India?
7. To consider a payment as salary, what kind of a relationship is mandatory between payer and payee?
8. The rental value of the property fixed by the municipal authorities for charging local taxes is known as
9. What is the basis of incidence of tax?
10. What are the conditions for allowing municipal taxes paid in the computation of income from house property?
11. Exactly how many categories of total income that one can explore?
12. What is meant by Indian Origin
13. What is the term used for cash payments made by an employer on a monthly basis other than salary or wages?
14. What income is not subject to tax?
15. What are referred to as companies that capture significant public interest?

**(10 X 1=10 marks)**

## SECTION B

### II Answer any 10 questions. Each question carries 2 marks

16. What is the difference between direct tax and indirect tax?
17. Briefly explain the allowable losses which are directly incidental to the business or profession of the assessee?
18. What is the residential status of a Hindu Undivided Family (HUF)?
19. Explain the concept of Gross total income?
20. Mr. Ramesh has two daughters. He receives children education allowance of ₹200 per month for his elder daughter and ₹100 per month for his younger daughter. Both his daughters are going to school. In addition, he also receives the following allowances:
  - ◊ Transport allowance – ₹2,000 per month
  - ◊ Tribal area allowance – ₹600 per month

Compute his taxable allowances.

21. Write a short note on deductions allowed while calculating the taxable income from salary?
22. What is unrealized rent and conditions for claiming unrealized rent?
23. From the following information compute the annual value of the house:
  - ◊ Municipal value - ₹ 3,00,000
  - ◊ Fair rent - ₹2,00,000
  - ◊ Standard rent - ₹2,70,000
  - ◊ Actual rent - ₹ 50,000 per month
  - ◊ Building remained vacant for two months during the previous year.
24. Why income tax is considered as a direct tax? List out the advantages of direct tax
25. What do you mean by fringe benefits? Give examples?

**(10X2=20 marks)**

## SECTION C

### III Answer any 5 questions. Each question carries 4 marks

26. Define capital asset as per the Income Tax Act. What types of assets are excluded from the definition of capital asset?
27. Explain the basis for determining the residential status of an individual under Section 6(1) of the Income Tax Act.
28. Mr. Ravi is a sole proprietor running a stationery business. The following are his business details for the previous year 2024–25:
  - ◊ Net profit as per Profit and Loss Account: ₹3,50,000
  - ◊ Depreciation charged in books: ₹40,000

- ◊ Depreciation as per Income Tax Act: ₹50,000
- ◊ Penalty paid for violating traffic rules: ₹5,000
- ◊ Donation made to a charitable trust: ₹10,000
- ◊ Audit fees unpaid as on 31st March 2025: ₹15,000

Compute the taxable income under the head 'Profits and Gains of Business or Profession' for the Assessment Year 2025–26.

29. Mr. Sameer, an Indian citizen, came to India for a visit during the previous year 2024–25. He stayed in India from 1st July 2024 to 31st December 2024. In the four years preceding 2024–25, his stay in India was as follows:

- ◊ 2020–21: 90 days
- ◊ 2021–22: 95 days
- ◊ 2022–23: 80 days
- ◊ 2023–24: 120 days
- ◊ His total income (excluding foreign income) for the previous year 2024–25 is ₹16,00,000.

Determine the residential status of Mr. Sameer for the Assessment Year 2025–26 with reasons.

30. Ms. Kaveri owns a self-occupied house property in Pune. She has taken a housing loan for the same. The following details are available for the previous year 2024–25:

- ◊ Interest paid on housing loan: ₹2,50,000
- ◊ Principal repayment: ₹50,000

Compute the income from house property for the Assessment Year 2025–26.

31. Mr. Vinay sold a piece of land on 10th December 2024 for ₹12,00,000. He had purchased the land on 1st June 2015 for ₹4,00,000. The fair market value as on 1st April 2001 was ₹3,00,000. The Cost Inflation Index (CII) for the relevant years are as follows:

- ◊ CII for 2001–02: 100
- ◊ CII for 2015–16: 254
- ◊ CII for 2024–25: 363

Compute the Long-Term Capital Gain for the Assessment Year 2025–26.

32. Explain the advantages of indirect tax.

33. Mr. Ramesh is employed in a private company. During the previous year 2024–25, he received the following:

- ◊ Basic Salary: ₹40,000 per month
- ◊ Dearness Allowance (forming part of retirement benefits): ₹10,000 per month
- ◊ House Rent Allowance (HRA): ₹15,000 per month

◊ Rent paid for a house in Mumbai: ₹18,000 per month

Compute the taxable amount of House Rent Allowance (HRA) for the Assessment Year 2025–26.

**(5X4=20 marks)**

## **SECTION D**

### **IV Answer any 2 questions. Each question carries 10 marks**

34. Mr. D furnishes the following details of his house property. Compute the Net Annual Value.

- ◊ Rent Received 1,75,000
- ◊ Municipal Value 1,70,000
- ◊ Fair Value 1,72,000
- ◊ Standard Rent 1,60,000
- ◊ Municipal Taxes 12% of Municipal Value
- ◊ Sanitation Surcharge 2% of Municipal Taxes

35. Explain the concept of residential status under the Income Tax Act, 1961. Discuss the conditions used to determine the residential status of individuals, Hindu Undivided Families (HUFs), and companies.

36. Anu installed a new plant for 20,00,000 on August 31, 2020. He received a grant from the Central Government exclusively for buying the new plant amounting to ₹ 500.000. In September 2023, the plant was destroyed by fire. The assessee realised ₹2,00,000 from the insurance company and ₹ 10.000 from scrap sale.

Compute the depreciation up to the assessment year 2023-24 and profit/loss for this plant for the assessment year 2024-25, allowing the rate of depreciation at 15%.

37. Mr. Raman submits the following particular of his business from which you calculate his income from the business for the assessment year 2024-25.

Net Profit as per P/L (before charging the following) Rs.1,25,000

- ◊ Sales tax Rs.20,000 and Income tax Rs.55,000
- ◊ Bad debts provision Rs.3000
- ◊ Commission to procure business order Rs.8,000
- ◊ Interest on capital Rs.38,000
- ◊ Depreciation Rs.4,000 (but as per income tax rules Rs.2,000 only)

**(2X10=20 marks)**

## സർവ്വകലാശാലാഗീതം

വിദ്യയാൽ സ്വത്രന്തരാക്കണം  
വിശ്വപ്രതരം മാറണം  
ഗഹപ്രസാദമായ് വിളങ്ങണം  
സുരൂപ്രകാശമേ നയിക്കണം

കൂദിരുട്ടിൽ നിന്നു തെങ്ങങ്ങളെ  
സുരൂവീമിയിൽ തെളിക്കണം  
സ്നേഹദീപ്തിയായ് വിളങ്ങണം  
നീതിവെജയയന്തി പാറണം

ശാസ്ത്രവ്യാപ്തിയെന്നുമേക്കണം  
ജാതിഭേദമാകെ മാറണം  
ബോധരശ്മിയിൽ തിളങ്ങുവാൻ  
അതാനക്കേന്നുമേ ജൂലിക്കണം

കുരീപ്പും ശ്രീകുമാർ

# SREENARAYANAGURU OPEN UNIVERSITY

## Regional Centres

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### Thalassery

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### Tripunithura

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NO  
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**LOVE YOURSELF  
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