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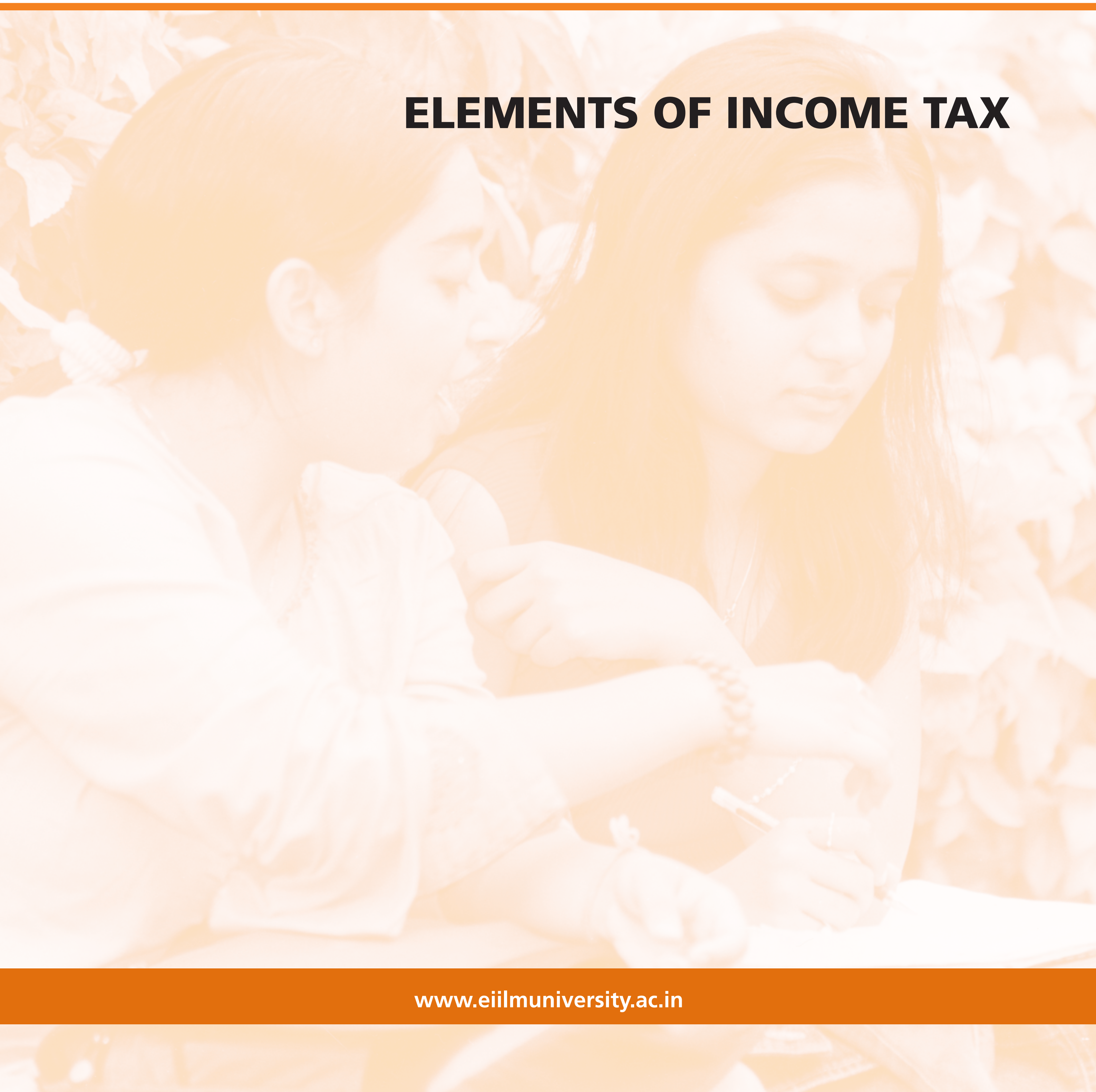

ELEMENTS OF INCOME TAX

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Subject: ELEMENTS OF INCOME TAX **Credits: 4**

SYLLABUS

Study of the Income-Tax

A comprehensive study of the Income-tax act 1961, Wealth-tax act, Case laws governing capital and revenue expenditure, Special Problems Centering on the concept of assesses, Registered Firm, Hindu Undivided family, Companies, Association of persons and trust, Minors, Cooperatives, non-resident Indias and avoidance of double taxation

Heads of Income

Problems covering heads of income salaries, Perquisites, gratuity and retirement benefits, Income from house property, Capital gains, income from other sources, Income from business and profession, Problems arising from aggregation of income and set off and carry forward of losses, Computation of income and Return of Income Tax, Filing procedure

Tax audit

Tax administration appeals, Revisions, review and rectification, Application to central Board of Direct Taxes, Acquisition Proceedings, Principles of valuation of movable and immovable property, Tax incentives and export promotion, Deductions under chapter VI, Other benefits and tax exemptions

Indirect Tax

Indirect Tax Laws, Administration and relevant procedures, The central excise including Central Value Added Tax (CENVAT), The Central Sales Tax Act, 1956 (74 of 1956), The Customs Act, 1962 (52 of 1962), Excise audit

Assessment of Tax Payable

Assessment of Tax Payable by the Assess under Indirect Taxes, Power of Different Authorities, Impact of Tax on Gatt 94 WTO, Anti Dumping Processing, Tariff Commission and other tariff authorities

Suggested Readings:

1. Charities An Exhaustive Treatise for Tax and Other....by S Rajaratnam , M. Natarajan , C.P. Thangaraj

2. Laws of Trade Tax Central Sales Tax and Tax on Ent....by O S Vatsa

3. Trade Tax, Central Sales Tax & Tax on Entry of Goo.... by Arvind Agarwal , Adarsh K Gupta

PART 1. FUNDAMENTAL

CHAPTER 1

Basic Concepts-I

STRUCTURE

- Learning objectives
- Introduction
- Broad mechanism of income tax in India
- Concept of income
- Definition of person
- Definition of assessee
- Permanent account number
- Assessment year
- Assessment year
- Previous year
- Taxation of previous year's income throughout the similar year
- Concept of total income
- Accounting method
- Review questions

LEARNING OBJECTIVES

After learning this chapter you should be able to:

- Explain the income tax administration in India.
- Describe specific conditions which are relevant for the revise of the subject.

INTRODUCTION

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

BROAD MECHANISM OF INCOME TAX IN INDIA

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

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

The administration of the Income Tax Act, 1962 is done through the Central Board of Direct Taxes (CBDT), which works under the supervision of the Ministry of Finance. The CBDT is charged with the duty of framing rules for the administration of the Income Tax Act. These rules, recognized as the Income Fax Rules, 1962, contain several shapes and miscellaneous details. The procedure of framing/rules is a very elaborate one, it involves notifying the rule first for public deliberation, and then for adoption. They are also placed on the tables of the House for information. These Rules are changed as and when the situation warrants.

The CBDT also issues from time to time, several circulars for the direction of the officials of the Income Tax Department and for Information of tax payers. It is so, necessary for a student of income tax to stay himself up-to-date with the latest provision. The best method to do this is to regularly read several tax journals and other tax publications.

The Finance Act

You may be aware that the Finance Minister of the Government of India presents an estimate of income and expenditure for the coming financial year to the Parliament usually on the last day of February every year. The document is popularly recognized as 'budget'. It is a significant event of the country as it provides the public a thought of the direction the Government is going to follow in the ensuing year. In order to provide legal form to several tax proposals, a bill is also moved which is recognized as Finance Bill. It contains several provisions as regards direct and indirect taxes. Once the Finance Act is passed, it becomes a law according to which several taxes are charged.

It is the Finance Act that contains the rate structure of income tax which would be applicable in that year. It is so, necessary that any student of income tax should not only revise the Income Tax Act but also the Income Tax Rules and the latest Finance Act. All these have to be studied simultaneously.

Scheme of Income Tax—an Overview

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

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

The income tax read beside with the Income Tax Rules and the Finance Act gives for all the possible situations that are likely to arise in the administration of income tax law. The Income Tax Act, 1961 extends to the whole country including the State of Jammu and Kashmir, Pondicherry, Dadra Nagar, Haveli, Goa, Daman and Diu and Sikkim.

It comprises of more than 400 sections, numbered from 1 through 298, and twelve Schedules of which five schedules, numbering sixth, eighth, ninth, and twelfth have been omitted.

CONCEPT OF INCOME

Since income tax is levied on the "income" of an entity, it is significant to know what income is and how it is computed. We will deal with the definition of income and some basic principles related to it.

Definition of Income

The term “Income” is defined in section 2(24) of the Income Tax Act, 1961. Though, since "Income" has a very broad scope, it is not possible to attribute some features to the term and describe it exhaustively. So, even the Income Tax Act, 1961, provides an inclusive definition of the term. It identifies what is incorporated in the term "Income".

Section 2(24) of the Act defines "Income" to contain the following items:

- Profits and Gains — this is one of the major sources of income.
- Dividends — the definition of dividend has been given in Sec, 2(22) which expands the meaning of the term.
- Voluntary Contributions received through a trust created wholly or partly for charitable or religious purposes or through an institution recognized wholly or partly for such purposes, or through a scientific research association or sports association. If the contribution is made with the specific instruction that it shall form a part of corpus of the trust or the institution, it shall not be treated as income.
- The value of perquisite or profit in lieu of salary. These have been defined, in Sec. 17 and will be dealt with while discussing income from 'salaries'.
- Any special allowance or benefit, other than perquisite incorporated in (4) above specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.
- Any allowances granted to the assessee either to meet his personal expenses at the lay where the duties of his office or employment of profit are ordinarily performed through him or at a lay where lie ordinarily resides to compensate him for the increased cost of livelihood.
- The value of any benefit or perquisite obtained from a company either through a director or through a person who has substantial interest in the company or through a relative of such director or person.
- The value of any benefit or perquisite, whether convertible into money or not which is obtained through a beneficiary or a trustee from a trust will be treated as taxable income in the hands of the beneficiary or the trustee, as the case may be.
- Any compensation or other payment made to the person managing the affairs of a company in connection with the termination of his office and income derived through a trade, professional or similar association

for specific services rendered or done to its members and chargeable profit under Section 59.

- The value of any benefit or perquisite whether convertible into money or not, arising from business or the exercise of a profession under Section 28 (IV).
- Capital gains arisen, from the transfer of a capital asset.
- The profits and gains of any business of insurance accepted on through a mutual insurance company or through a cooperative society computed in accordance with Section 44,
- Any sum chargeable to income tax as profits and gains of business or profession or as recovery of losses, expenses, or trading liability in respect of which the assessee had been granted a deduction in a previous year or deemed profits.
- Profit on sale of a license granted under the Imports (Control) Orders, 1955.
- Any cash assistance received or receivable through any person against exports under any scheme of the Central Government.
- Any duty of customs or excise repaid or repayable to any person against exports. Against exports.
- Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort and betting of any form or nature whatsoever.
- Any sum received through the assessee from his employees as contributions to any
- Provident finance or superannuation finance set up under the Employees' State insurance Act or any other finance for the welfare of such employees.

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

Basic Principles

The Act does not describe the concept of income but merely states what amounts are to be incorporated in the term 'Income'. The word income has been given a very wide meaning. So, in the absence of any such guidelines, the Income Tax Department and the tax payers have to depend upon the several judgments of the High Courts and the Supreme Court.

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

- The word ‘Income’ connotes a periodical monetary receipt coming in from some definite source with some sort of regularity. The source need not be a continuously productive one, but necessity is one whose substance is the manufacture of income.
- Income is a periodical yield measurable in conditions of money or money's worth and arises out of use of real or personal property i.e. the income may be received in cash or type. Therefore the receipts in type, which can be measured in conditions of money, shall be taxable.
- Periodicity or regularity or at least expected regularity is significant elements of income. Regularity does not imply that a single receipt is not income.
- Income comprises monies that have become due though not received.
- A receipt which is income’ will continue to be so even if it is exempted from tax.
- Income means real income. Fictional or technological income cannot be termed income for the purposes of the Income Tax Act, 1961.
- Income necessity come from outside. Pocket money received through a student from his father cannot be termed income.
- Legality or otherwise of income or source of dictate whether a receipt can be termed income. You are required to pay tax on illegally earned income as well. This though, does not grant immunity from prosecution.

DEFINITION OF PERSON

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

- An individual,
- A Hindu undivided family,
- A company
- A firm,

- An association of persons or a body of individuals whether incorporated or not,
- A local authority, and
- Every artificial juridical person not falling within any of the categories mentioned above.

It will therefore be seen that the word person in defined in very wide conditions. A minor would also be incorporated in the definition of persons in some circumstances. All the persons are liable to pay income tax under the Income Tax Act, 1961.

DEFINITION OF ASSESSEE

The term "assessee" has been defined in Section2 (7) of the Income Tax Act, 1961: “Assessee” means a person through whom any tax or any other sum is payable under this Act. The term is defined to contain the following:

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

An assessee in default is a person

- Who is liable to deduct tax at source but does not do so,
- Who deducts the tax but does not pay it to the government,
- Who fails to pay installments of advance income tax in time?

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

PERMANENT ACCOUNT NUMBER

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

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

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

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

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

ASSESSMENT YEAR

Assessment Year (AY) is defined in Section 2(9) of the Income Tax Act, 1961. "If means the era of 12 months commencing on the April 1, of each year and ending on March 31 after that. For instance, the current assessment year is 1990-91 which commences on April 1, 1990 and will end on March 31, 1991.

It is the financial year in which the assessment takes lay. An assessee is required to pay tax in the AY on the income that was earned through him in the previous year according to the rates of tax prescribed through Annual Finance Act. To illustrate, the current assessment year is 1990-91 and an assessee is required to pay tax in this AY on the income that was earned through him in the previous year 1989-90,

As a precaution, it should be pointed out here that there are a few exceptions to the common rule that income earned in the previous year only is taxed in the assessment year.

PREVIOUS YEAR

Income is earned in one year but is taxed in the after that. The year in which Income is earned is recognized as Previous Year (PY) and the year in which it is taxed is termed as Assessment Year.

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

- Previous year means the financial year immediately preceding the assessment year.

- Previous year in relation to the assessment year commencing on 1.4.89, means the era of 12 months which ends on, any day throughout the financial year immediately preceding the AY.

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

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

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

In both the examples, the previous year exceeded 12 months. This elongated previous year throughout the middle era would cause hardship to assesses and in some cases deprive them of the full benefit of sure deductions and concessions. Schedule 10 takes care of this. The monetary limit of the deductions is increased proportionately. For instance casual income under Sec. 10(3) is exempt up to Rs. 5,000. In case the Middle Previous year is of 15 months duration the amount will be increased through one-fourth i.e. (5,000 plus 5, 00014 = Rs. 6,250) or the amount of deduction shall be arrived at through multiplying the amount through a fraction in which the numerator is the number of months in the middle previous year and the denominator is twelve i.e. Rs. 6,250 (5,000 x 15/12).

TAXATION OF PREVIOUS YEAR'S INCOME THROUGHOUT THE SIMILAR YEAR

As stated earlier the income of the previous year is taxed in the assessment year. But there are sure incomes for which the tax is paid in the similar year.

Income on Non-Resident Shipping Companies

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

Income of Persons Leaving India

Section 174 gives that if the Assessing Officer feels that an individual may leave India without the intention of coming back, he may determine the total income of the person from the date of expiry of the immediately preceding previous year to the date of planned departure. The Assessing Officer will also compute the tax payable and will inquire the individual to pay the tax so computed before leaving the country.

Income of Persons Trying to Alienate their Assets

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

Income of Discounting Business

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

CONCEPT OF TOTAL INCOME

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

- Compute taxable income under several heads of income i.e. salaries, house property, profits and gains of business and profession, capital gains and other incomes, through allowing deductions in respect of expenses incurred through the assessee in earning those incomes up to the extent permissible under the provisions.

- Net result of adding taxable incomes from several heads of income is Gross Total Income.
- Out of the gross total so computed create the deductions allowed under Section 80 A to 80 U etc. in respect of several expenses such as LIC premium, contribution to Provident Finance, Medical Expenses etc, and several incomes such as dividends, interests etc.

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

ACCOUNTING METHOD

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

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

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

An assessee who intends to change his method of accounting is required to create an application to the Assessing Officer. His necessity proves that: the change is regular and not for a casual era and if it is bonfire the Assessing Officer has no cause to reject this change. It has been held in Ramswarup Bengalimal v. CIT 25 ITR 17 that the burden of providing that the method of accounting has been changed lies on the Department. Bansilal Abirchand v. CIT 3 ITC 57 holds that if the Department has been accepting the assessee's method of accounting for a number or years, they cannot arbitrarily seek to take him on a dissimilar foundation in a scrupulous year.

REVIEW QUESTIONS

- Who is an 'assessee in default'?
- "The income of the previous year is taxed in the current year". Explain.
- Distinguish flanked by :
    a. Gross total income and total income.
    b. Previous year and Assessment year.

CHAPTER 2

Basic Concepts-II

STRUCTURE

- Learning objectives
- Agricultural income
- Concept of casual income
- Capital and revenue receipts importance of distinction
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Explain agricultural income, and taxation thereof,
- Explain casual income and tax treatment thereof,
- Differentiate flanked by capital and revenue.

AGRICULTURAL INCOME

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

Definition of Agricultural Income

Agricultural income as defined under Section 2(1) means any rent or revenue derived from land which is situated in India and is used for agricultural purposes (2(1)(a)).

The definition creates it very clear that any rent or revenue (in cash or type) will be agricultural in nature only if the following circumstances are fully satisfied:

- Rent or revenue is derived from land,
- The land is situated in India, and
- The land is used for agricultural purposes.

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

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

- Agriculture in its mainly primary sense denotes the cultivation of the field and is restricted to the cultivation of the land in the strict sense of the term, meaning thereby tilling of land, sowing of seeds, planting arid similar operations on the land. It also comprises in its scope all the operations which foster the growth and preservation of the produce beside with the operations required to create the produce marketable. The term comprises within its scope all kinds of produce regardless of its nature.

- In order to decide whether a scrupulous piece of land has been used for agricultural purpose, there has to be some measure of cultivation of land and some expenditure of ability and labour upon it. Consequently, income from the sale of forest trees rising naturally and without any human intervention cannot be treated as agricultural income.

Types of Agricultural Income

Agricultural Income is of five types

- Any rent or revenue derived from land
- Income derived from Agriculture
- Any income derived from marketing procedure performed through cultivator or receiver of rent in type
- Any income derived from the sale of product
- Income from farm structure.

Any Rent or Revenue Derived from Land

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

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

Income Derived from such Land through Agriculture or from Manufacturing Procedure (2(1A) (b))

The words such land is of significance here. These words limit agricultural income to the land situated in India which is used for agricultural purposes. The income generated through the following behaviors is measured agricultural income:

- Agriculture
- Procedure ordinarily employed through a cultivator to render the produce marketable
- Sale through cultivator of the produce without any further processing except the one mentioned in (2nd) above.

It is therefore clear that the cultivator may need to create the produce marketable as the produce as such may not be sold. He is allowed the use of a procedure which is usually employed through all the cultivators to create the produce marketable. Tobacco leaves are usually dehydrated before being sold, and so, the income from the sale of dehydrated tobacco leaves will be agricultural in nature. Though, the income from the sale of besides made out of the similar tobacco will not be treated as agricultural income, because marketable produce has been further processed and made more valuable.

Income from Agricultural House Properly a Farm Buildings (2 (1A) (c))

Income derived from any structure in the following cases wills he agricultural income:

- The structure is owned and occupied through the receiver of rent or revenue of any such land;
- The structure is on or in the immediate vicinity of the agricultural land in India;
- The agriculturist needs it through virtue of his connection with the land and uses it as a dwelling house, store house or as an outhouse;

- The land on which such structure is situated necessity be subject to land revenue in India or subject to a local rate assessed and composed through the officers of the said government;
- If the land is not subject to land revenue, it necessity be outside the urban area, i.e., area comprising a cantonment board, municipal board, notified area, town area, municipal corporation or any other name through which it is recognized and which has a population of 10.000 or more;
- If it is notified through the central government in the official gazette, it necessity not be situated within a aloofness of 8 kilometer or within the area of such lower limits from the jurisdiction of such municipal board etc. as the Central Government may notify in this regard.

Instances of Non-agricultural Income

The following incomes though linked with land arc not agricultural in nature:

- Annuity payable to Vendor of agricultural land or to a person giving up his claim to a piece of agricultural land.
- Commission for selling agricultural produce.
- Income from Dairy Farm.
- Forest produces resulting from wild growth.
- Fisheries.
- Ginning of cotton.
- Harvesting of crop on purchased land,
- Letting out of land for stocking timber or crops.
- Dividend paid out of agricultural income.
- Commission earned through the landlord for selling agricultural produce.
- Profit earned on purchase of standing crop.
- Rearing of silk worms.
- Income from quarries.
- Royalty income of mines.

- Income from poultry farming.

Partly Agricultural Income

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

Taxation of Agricultural Income

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

As per the provision of the act the agricultural and non-agricultural income of the individual earning both the incomes will be clubbed jointly to discover out the rate of tax to be applied for calculating the income tax on non-agricultural income. This will result in a higher income tax as compared to what he would have paid had he not clubbed the, two kinds of income. The provisions are that all assesses other than companies, registered firms, and cooperative societies are required to club the agricultural income with other incomes for determining the rate of tax. ii) These provisions will apply only if the non-agricultural income exceeds minimum taxable limit (Rs. 22,000) and agricultural income exceeds Rs. 600.

CONCEPT OF CASUAL INCOME

One of the significant features of the term 'income' is its regularity or at least expected regularity. Though, there may be sure incomes which are not regular and which do not arise from any source of income. They are recognized as 'casual incomes'.

Definition of Casual Income

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

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

Winning from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever, are also treated as casual incomes and are not taxable upto a maximum of Rs. 5,000. One test which has been laid down in some cases is whether the receipt is one which is foreseen, recognized and anticipated and provided for through agreement. If it is a result thereof, it cannot be described, as casual even if it is not likely to recur for a considerable time. Casual receipts are so receipts which are purely accidental and a result of windfall. They accrue without stipulation, contract, calculation, and design.

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

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

- Capital Gains
- Receipts arising from business, profession or job
- Receipts through method of addition to the remuneration of any employee e.g. bonus.

Casual Income or Personal Gift

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

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

Changeability of Casual Income

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

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

A Few Examples

The following incomes are of a casual nature

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

The following incomes are not of a casual nature

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

CAPITAL AND REVENUE RECEIPTS IMPORTANCE OF DISTINCTION

If is significant to be able to distinguish flanked by capital and revenue. The distinction is important not only from the point of view of accounting but also for tax matters. Ordinarily speaking when we buy something of durable nature we say that we have incurred capital expenditure. For instance buying of furniture is capital expenditure and it is shown on the assets face of the Balance Sheet. On the other hand, expenditure incurred on repairs is supposed to be of routine kind and it is so shown on the debit face of the Profit and Loss Account. In the similar method when some receipt is affected for unloading of a capital asset, we classify it as capital receipt. For instance, an amount of Rs. 2, 00,000 received on the sale of a piece of land will be a receipt of capital nature. On the other hand fees received through an advocate for rendering of professional services will be of revenue nature. It might be of interest to note that the Income Tax Act, 1961, has not defined the concept of capital and revenue anywhere and so we have to depend on the accounting conventions and pronouncements through courts in this area.

Separately from accounting implications, the distinction flanked by capital and revenue receipts is of great significance in tax matters and in determining the tax liability. Revenue receipts are measured to be taxable in common whereas capital receipts are not. Though, where the asset sold brings in some surplus (excess of selling price in excess of the cost of an asset), it is termed as capital gain and will be treated under special provisions of the Act. Tax liability so cannot be determined accurately if the receipts are not properly classified.

Distinguishing Tests

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

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

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

- ***Nature of receipt at the initial stage:*** If the receipt at the initial stage possesses the features of a trading receipt, it will be taxed as such. If though, at the initial stages, it looks like a capital receipt, it cannot be taxed irrespective of the magnitude and the appropriation of the similar through the assessee.
- ***Nomenclature not decisive:*** Irrespective of what the parties to a contract call the transaction and the receipt arising therefrom, the true nature of the receipt has to be ascertained based on the principles laid down and the circumstances of the case.
- ***Nature of receipt in the hands of the receiver:*** It is significant to note that when considering a receipt, its nature in the hands of the receiver

is significant. This implies that even if a thing of expenditure is of a capital nature in the hands of the giver, it very well could be a thing of revenue receipt in the hands of the receiver. It is so, the nature of receipt in the hands of the receiver that is significant and not the nature of the expenditure in the hands of the giver.

- ***Nature under company law not significant:*** It has been held through the Supreme Court that there is no inconsistency flanked by a receipt being a capital receipt under the Company Law and being a revenue receipt under the Income Tax Act, 1961.
- ***Lack of assessment in earlier years immaterial:*** The mere information that the Income Tax Authorities have failed to levy tax on the interest part of the annual receipt does not change the nature of the receipt. It continues to be part capital and part revenue in nature and thereby chargeable to tax on the revenue part.
- ***Income from consumable assets:*** Profits arising from consumable assets would be of a revenue nature although capital asset appears to be getting exhausted or consumed.
- ***Swap rate fluctuation:*** Excess income arising to the assessee as a result of swap rate fluctuation will be taxed as revenue receipt. If, though, the profit arises not as a result of the business of the assessee but as accrual to the investment, it will be treated as a capital receipt.
- ***Perpetual annuity:*** The annuity receivable in swap for a capital asset is taxable income. Though, if the annuity is described as installment of a capital sum received in swap for the capital asset, it is not taxable.

Examples of Capital and Revenue Receipts

The following are a few examples of capital receipts

- Receipt to meet the capital expenditure is a capital receipt.
- Compensation received for the suspension of an export license.
- Pagdee received as consideration for grant of monthly tenancies.
- Profit due to fluctuations in the rate of swap of foreign currency.

- Profit from the sale of foreign swap when the purchase of capital goods in foreign country became impossible.
- Entrance fee composed through a company in respect of new shares.
- Sale of assets of a firm at the time of its conversion to a company to the extent the consideration is attributable to sale of land.
- Compensation received for relinquishing the rights of a partnership.

The following are a few examples of revenue receipts:

- Receipt of annuity for transfer of a capital asset.
- Compensation received for compulsory acquisition of land.
- Damages received in respect of repairs not accepted out in time.
- Cash assistance received under an export promotion scheme.
- Lump sum amount received for waiver of royalty.
- Subsidy received through a cooperative society from Government.
- Surplus left with the seller due to a reduction in export duty.
- Damages receive through a company for breach of contract.
- Sale of import entitlement received under an export promotion scheme against export.

REVIEW QUESTIONS

- Distinguish flanked by casual income and gift.
- Describe agricultural income and provide examples.
- Distinguish flanked by agricultural income and partly agricultural income with examples.
- What do you understand through casual income? How are they treated under the Income Tax Act?
- Distinguish flanked by capital and revenue incomes.

CHAPTER 3

Residential Status and Tax Liability

STRUCTURE

- Learning objectives
- Importance of residential status
- Categories of residential status
- Rules for determining the residential status
- Scope of total income on the foundation of residence — section (5)
- Types of income
- Incidence of tax
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Identify categories of assesses on the foundation of residential status,
- Determine the residential status of assesses,
- *E*xplain dissimilar kinds of incomes,
- Determine tax liability.

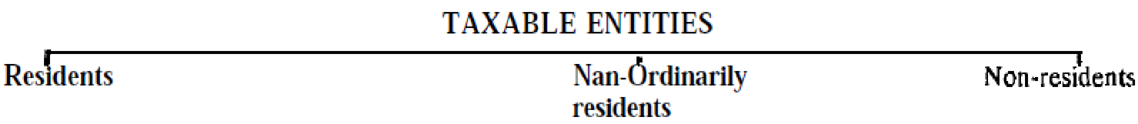
IMPORTANCE OF RESIDENTIAL STATUS

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

CATEGORIES OF RESIDENTIAL STATUS

Section 5 of the Income tax Act deals with the scope of total income. It states that the scope of total income of a person is determined through reference to his residence in India in the previous year. On the foundation of residence all taxable entities are divided into three categories, viz.

- Persons who are residents in India
- Persons who are not ordinarily residents in India
- Persons who are non-residents in India



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

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

RULES FOR DETERMINING THE RESIDENTIAL STATUS

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

Individual

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

Resident

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

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

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

Explanations; In Case of an Individual

- Being a citizen of India if he leaves India in any previous year for the purpose of employment outside India, the era of 60 days in clause (b) above will be extended to 182 days or more.
- Being a citizen of India or a person of Indian origin, who being outside India, comes on a visit to India in any previous year the era of 60 days mentioned in clause (b) will be 90 days or more (From 1.4, 1990 these 90 days are extended to f50 days or more). A person is deemed to be of Indian origin if he or either of his parents or any of his grand parents was born in undivided India.

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

- If he has been resident in India in at least 9 out of the 10 years preceding the previous year, and
- He has been in India for an era or periods amounting in all to 730 days or more throughout 7 previous years proceeding the previous year.

Stay in India

His stay in India for at least 182 days throughout the previous year need not necessarily be a continuous one and at the similar lay, it is the total duration of his stay in India that will be measured for the purpose. It is immaterial whether he stayed in a rented 'house, or his own house, in a hotel or with some friends, what is significant is that he necessity have stayed in India for a era of 182 days or more in the previous year.

Concerning his stay for at least 365 days, the stay may be regular or irregular or only once in four years proceeding the previous year. But his necessity has stayed in India 365 days in all throughout the four years. The era of 4 years preceding the previous year means the era of 12 calendar months each immediately preceding the commencement of the relevant previous year.

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

Non-Company Plural Entities

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

Hindu Undivided Family (Section 6(2)):

- The residential status of an HUF depends on two factors, the site of control and management of its affairs and the residential status of its Karta.

Ordinarily Resident (Section 6(2)):

- HUF is said to be ordinarily resident in India in any previous year :
- If the control and management of its affairs is wholly or partly situated in India throughout the previous year.

The expression 'Control and Management' signifies controlling and directive power. In other words it means the 'head and brain.' Moreover the control and management should be de facto, (in effect) and not merely the right or power to control and manage. If its manager (Karta) satisfies the following circumstances of Section 6(6):

- Its manager has been resident in India in 9 out of 10 previous years preceding that year; and
- Its manager has, throughout the 7 years preceding that year, been in India for an era amounting in all to 730 days or more.

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

Companies (Section 6(3))

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

Resident

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

- It is an Indian company, or

- Throughout the year, the control and management of its affairs is situated wholly in India.

Indian Company: Section 2(26)

Indian company means a company shaped and registered under the Companies Act, 1956 and comprises:

- A company shaped and registered under any law relating to companies formerly in force in any part of India, other than the state of Jammu and Kashmir and the union territories,
- A corporation recognized through or under a central, or state or provincial act.
- Any institution, association or body which is declared through the Central Board of Direct Taxes to be a company under Section 2(17),
- In the case of Jammu and Kashmir, a company shaped and registered under any law for the time being in force in that state.
- In the case of any of the union territories of Dadra and Nagar Haweli. Daman and Diu and Pondicherry, a company shaped and registered under any law for the time being in force in that union territory.

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

Control and Management of the Affairs of the Company

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

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

Non-Resident

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

Every other Person (Section 6(4))

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

SCOPE OF TOTAL INCOME ON THE FOUNDATION OF RESIDENCE — SECTION (5)

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

- Residents
- Not-ordinarily residents
- Non-residents

Resident

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

- Is received, or deemed to be received in India in such year through him or on his behalf; or
- Accrues or arises or is deemed to accrue or arise to him in India throughout such year; or
- Accrues or arises to him outside India throughout such year.

Not Ordinarily Resident

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

- Is received or is deemed to be received in India in such year through or on behalf of such person; or
- Accrues or arises or is deemed to accrue or arise to him in India throughout such year; or
- Accrues or arises to him outside India deriving such 'year and is derived from business controlled in India or a profession set up in India.

Therefore it will be seen that the vital variation flanked by the scope of a total income of a resident and not ordinarily resident relates to the income which accrues or arises to him outside India. In case of a resident it is incorporated in his total income irrespective of the source of such income. But in case of a not ordinarily resident it will be incorporated in his total only if it is derived from a business which is controlled in or a profession set up in India.

Non-Resident

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

- Is received or is deemed to be received in India in such year through or on behalf of such person, or
- Accrues or arises or is deemed to accrue or arise to him in India throughout such year.

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

TYPES OF INCOME

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

- Incomes received in India.
- Incomes deemed to be received in India.
- Incomes accruing or arising in India.
- Incomes deemed to accrue or arise in India.

Income Received in India

- Income received in India is taxable in all cases irrespective of residential status of the assessee. The following points are worth noting:
- Income received means the first receipt. It means the income should be received through the assessee for the first time under his control, in India. For instance, salary received through an employee in India is taxable. But salary received through a non-resident individual for the first time outside India and remitted to India afterwards cannot be taxed, because the income cannot be treated as received twice— once outside India and once inside it.
- It is not necessary that income should be received in cash. It may be received in type also. For instance rent-free accommodation and sure other facilities provided to an employee are taxable as 'salary' in the hand of the employee though th6 income is not received in cash.

Though income may be received in type but for this to be so it is essential that what is received in type should be the equivalent of cash or should be money's worth e.g. A debtor who provides his creditor a promissory note for the sum he owes can in no sense be said to pay his creditor.

- Tax is attracted through any such income which is received in India whether accrued here or not.

Income Deemed to be Received in India

The expression 'deemed to be received' only means that although such incomes are not received through the assessee they are treated through law as having been received. The phrase 'statutory receipt' may conventionally be employed to cover such income. Instance of such statutory receipt are to be establish in the provisions of the Act, e.g., Section 7 and Section 198

- Excessive contribution etc. to the Employee's provident finance. Rule 6 of part A of the Fourth Schedule to the Act gives that, that portion of the annual accrution in any previous year to the balance at the credit of an employee participating in a recognized provident finance, as consists of the following conditions, shall be deemed-to have been received through the employee in that previous year
    c. Contributions made through the employer in excess of ten, per cent of the salary of the employee and
    d. Interest credited on the balance to the credit of the employee in excess of 12%.
- Portion of transferred balance to employee's credit on the date of recognition of Provident Finance Rule 11 of Part A of the fourth schedule gives for treatment of existing balances where recognition is first accorded to an old provident finance. According to this rule the Income Tax Officer shall create a calculation of the aggregate of all sums comprised in a balance transferred to the credit of an employee's account which would have been liable to tax had the finance been

recognized on the date of its institution and such aggregate shall be deemed to be the income received through the employee,

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

Income Accruing or Arising in India

Income is said to be received when it reaches the assessee, but when the right to receive the income becomes vested in the assessee, it is said to accrue or arise. Accrual of income means a stage where the assessee has acquired a right to receive such income, when the similar income is actually received in the accounting year it is said to arise. Income accrues when the right to receive it comes into subsistence: but it arises when the method of accounting shows it in the form of profits or gains. The income necessity accrues or arises in India. If it accrues or arises outside India; it cannot be taxed under the hands of person who is non-resident in India.

Income Deemed to Accrue or Arise in India

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

- Income is deemed to accrue or arise in India, if it accrues or arises, directly or indirectly:
  - e. Through or from any business connection in India
  - f. Through or from any property in India.
  - g. Through or from any asset or source of income in India, and
  - h. Through or from any transfer of a capital asset situated in India.

Explanation

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

INCIDENCE OF TAX

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

Table 3.1. Highlights that the Tax Incidence is the Highest in the Case of a Resident and not Ordinarily Resident and Lowest in the Case of Non-resident.

Particulars of Income	Tax Liabilit in case of Resident	[illegible] ordinarily resident	Non-resident
1) Income received in India whether accrued in India or outside India.	Yes	Yes	Yes
2) Income deemed to be received in India whether accrued in India or outside India.	Yes	Yes	Yes
3) Income accruing or arising in India whether received in India or outside India.	Yes	Yes	Yes
4) Income deemed to accrue or arise in India whether received in India or outside India	Yes	Yes	Yes
5) Income received and accrued outside India from a business controlled in India or a profession set up in India.	Yes	Yes	No
6) Income received and accrued outside India from a business controlled from outside India or a profession set up outside India.	Yes	No	No
7) Income earned and received outside India but later on remitted to India.	No	No	No

REVIEW QUESTIONS

- Who is a non-resident?
- Explain 'Income deemed to be received in India.'
- What are the dissimilar categories into which assesses are divided on the foundation of residence?
- What are the criteria for determining the residence of a firm and a company?
- What is the foundation of charge of income tax? Provide the rules for determining this.
- Explain the provisions of income tax act for an individual if he is a
    - Resident

- Not ordinarily resident
- Non-resident

CHAPTER 4

Exempted Incomes Under Section 10

STRUCTURE

- Learning objectives
- Meaning of exempted income
- List of exempted incomes
- Sure exempted incomes in the hands of an individual
- Income of charitable and religious trusts and political parties
- Learning objectives

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Explain what is exempted income and provide reasons for the similar,
- Classify exempted incomes,
- Prepare the list of exempted incomes under Section 10,
- Explain several exempted incomes in the hands of an individual,
- Explain the provisions concerning incomes of charitable and religious trust and political parties.

MEANING OF EXEMPTED INCOME

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

- Incomes which do not form part of total income nor is income tax payable on them. They are described fully exempted incomes.
- Incomes which are incorporated in the total income but are exempt from income tax at the average rate of income tax applicable to the total income. They are described partially exempted incomes.
- Incomes of sure Organizations or authorities are exempted subject to fulfillment of the required circumstances.

LIST OF EXEMPTED INCOMES

As stated in Section 4.2 exempted incomes arc divided into three categories. Fully exempted incomes, partially exempted incomes and incomes of sure organizations. It necessity, though, be mentioned that in sure cases a limit to the quantum or era is fixed to prevent misuse of the provision e.g. casual income is exempted up to Rs. 5,000 only. Let us now list the incomes under these three categories:

- Fully Exempted Incomes (Section 10)

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

   n. Sure Tax free incomes in the hands of individuals

      i. Agricultural Income — Sec. 10(1).
      ii. Sums received from HUF — Sec. 10(2).
      iii. Casual and non-recurring incomes — Sec. 10(3).
      iv. Travel concession or assistance— Sec. 10(5).
      v. Allowances and perquisites for foreign service to citizens of India—Sec. 10(7).
      vi. Salaries in connection with cooperative technological assistance programme —Sec. 10(8)(9),
      vii. Death-cum-retirement gratuity — Sec. 10(10).
      viii. Commuted value of pension — Sec. 10(10A).
      ix. Encashment of earned leave — Sec. 10(10AA).
      x. Retrenchment compensation to workers — Sec. 10(10B).
      xi. Payment received through an employee of a Public Sector Company for voluntary retirement — Sec. 10(10C).
      xii. Payment from Statutory and Public Provident Finance — Sec. 10(11).
      xiii. Payment from Recognized Provident Finance — Sec. 10(12).
      xiv. Payment from Approved Super annuation Finance — Sec. 10(13).
      xv. House Rent Allowance — Sec. 10(13A).

xvi. Special Allowance or benefit —-Sec. 10(14).

xvii. Receipt of Swap Risk Premium through Public Financial Institution —Sec. 10(14 A).

xviii. Interest on sure Government Securities and Deposits — Sec. 10(15).

xix. Payment of lease rent — Sec. 10(15A).

xx. Scholarships—Sec, 10(16).

xxi. Awards — Sec. 10(17A).

xxii. Ex-gratia payments through Central Government — Sec. 10(18A).

xxiii. Annual value of Palace of Ruler — Sec. 10(19A).

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

xxv. Subsidy from or through sure boards — Sec. 10(31).

o. Incomes accruing to sure authorities

i. Sure incomes of a local authority — Sec. 10(20).

ii. Income of a Housing authority — Sec. 10(20A).

iii. Income of approved Scientific Research Association— Sec. 10(21).

iv. Income of an educational institution — Sec. 10(22).

v. Income of medical institution — Sec. 10(22A).

vi. Income of sports association — Sec. 10(23).

vii. Income of an association recognized to encourage sure professions —Sec. 10(23 A).

viii. Income of any Regimental Finance of the Armed Forces — Sec. 10(23AA).

ix. Income of Khadi and Village Industries — Sec. 10(23B).

x. Income of Khadi and Village Industries Board — Sec. 10(23BB).

xi. Income of statutory bodies for the administration of Public Charitable Trust —Sec. 10(23BBA).

xii. Income of sure national funds — Sec. 10(23C).

xiii. Income of Mutual Finance — Sec. 10(23D).

xiv. Income of Swap Risk Administration Finance — Sec. 10(23E).

xv. Income of a Registered Trade Union — Sec. 10(24).

xvi. Income on behalf of sure funds — Sec. 10(25).

xvii. Income from statutory corporations/bodies for promoting the interests of scheduled castes/tribes — Sec. 10(26B).

xviii. Income of a marketing authority — Sec. 10(29).

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

i. Passage money.

ii. Remuneration received through an ambassador etc.

iii. Remuneration received through an employee of a foreign enterprise.

iv. Remuneration received from foreign philanthropic organizations.

v. Income in the hands of a technician.

vi. Employment on a foreign ship

vii. Employment as a professor or other teacher.

viii. Employment for research.

ix. Remuneration in Training.

q. Income in the hands of non-residents

i. Sure interest received through non-resident Indian Citizens —Sec. 10(4) and (4B).

ii. Remuneration received for rendering service in connection with shooting of a cinematography film in India — Sec. 10(5A).

iii. Fee for technological services received through a foreign company — Sec. (6A).

iv. Tax paid on behalf of a non-resident — Sec. 10(6B).

v. Income of a foreign company from technological services — Sec. 10(6C).

r. Miscellaneous incomes

i. Allowances to members of Parliament and Members of Legislature — Sec. 10(17)
ii. Income of a Member of a Schedule Tribe — Sec, 10(26).
iii. Winnings from lottery through agents — Sec. 10(26AA).
iv. Tax-credit certificates—Sec. 10(28).

s. Income of Newly Recognized Industrial Undertakings in Free Trade Zones — Sec. 10(A).
t. Income from Newly Recognized Hundred Per-cent Export Oriented Undertakings — Sec. 10(B).

- Partially Exempted Incomes — Sec, 86
  u. Share from unregistered firm.
  v. Share from association of persons.
- Income of Charitable and Religious Trust and Political Party
  w. Income of Public Charitable and Religious Trusts — Sec. 11, 12, 13.
  x. Income of a Political Party — Sec. 13 A,

SURE EXEMPTED INCOMES IN THE HANDS OF AN INDIVIDUAL

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

- Agricultural Income — Sec. 10(1)

Sums Received from Hindu Undivided Family — Sec. 102.

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

Casual and Non-Recurring Income — Sec. 10(3)

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

- Capital gains chargeable under Sec. 45
- Receipts arising from business, profession, or job.
- Receipts through method of addition to the remuneration of an employee.

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

Salaries in Connection with Cooperative Technological Assistance Programme — Sec. 10(8) (9)

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

Death cum retirement gratuity — Sec. 10(10), Commuted value of pension — Sec. 10(10A), Encashment of earned leave — Sec. 10(10AA), Retrenchment compensation to workers — Sec. 10 (10B), Payment received through an employee of a public sector undertaking for voluntary retirement.

Payment from Statutory and Public Provident Finance Sec. 10(11), Payment from Recognized Provident Finance — Sec. 10(12), Payment from approved superannuation Finance.

House Rent Allowance Set. 10(13A), Special Allowance for meeting business expenditure.

Swap Risk Premium — Sec. 10(14A)

Any income received through a public financial institution as swap risk premium from the persons borrowing foreign currency from such institution, provided that the amount of premium is credited in the Swap Risk Administration Finance.

- Payment of Lease Rent — Sec. 10(15A): Any payment made through an Indian company occupied in the business of operation of aircraft to acquire an aircraft on lease from the Government of a foreign state or a foreign enterprise under an agreement approved through the Central Government in this behalf.
- Scholarships — Sec. 10(16): Scholarships granted to meet the cost of education is exempt.
- Awards — Sec. 10(17A): Any payment made whether in cash or type through the State or Central Government or a body approved through Central Government in pursuance of any award instituted in the public interest is exempted.
- Ex-gratia payments — Sec. 10(18A): Any ex-gratia payment made through the Central Government consequent on the abolition of privy purse is exempt.

- House of a Ruler — Sec. 10(19A): The annual value of any one palace in the job of a ruler is exempt.
- Subsidy from Tea Board — Sec. 10(30): The amount of any subsidy received through an assessee from Tea Board, for rising and manufacturing tea in India is exempted throughout that assessment year, provided the assessee produces a certificate for the amount of subsidy received from the Tea Board.
- Subsidy from or through sure Boards — Sec. 10(31): The amount of any subsidy received through an assessee occupied in the business of rising and manufacturing, rubber, cardamom or other specified commodity in India, from or through the Rubber Board, Coffee Board, Spices Board or any other Board will be exempt subject to the producing of a certificate through the assessee for the amount of subsidy received through him from the Board.

INCOME OF CHARITABLE AND RELIGIOUS TRUSTS AND POLITICAL PARTIES

The income of Charitable and religious trust and political parties are exempt under 'Income Tax Act.

Income of Charitable and Religious Trusts

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

Charitable Purposes — Sec. 2(15)

Charitable purposes contain the following:

- Relief to the poor
- Promotion of Education or literacy
- Hospital or Medical facilities to common public at no cost

- Any other activity in the category of charitable purpose.

Religious Purposes

Religious purposes mean a trust for the advancement, support, or propagation of a scrupulous religion. But it necessity be a public religious trust.

Formation of Religious and Charitable Trusts

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

- The trust should get itself registered with the Commissioner of income tax within one year from the establishment of the trust.
- If the total income of the trust exceeds Rs. 25,000 in any previous year, the accounts necessity be audited through a chartered accountant and the statement of such audit should be attached with the return of the income.
- The funds of the trust should be invested or deposited in any one or more of the specified manners mentioned in Sec. 11(5) of the Act.

Tax Exemption for Trusts — Sec. 11 and 12

The following incomes of a trust are exempt from tax:

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

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

- The property from which the income is derived necessity be held under trust or other legal obligation. But, the profit and gains of any business accepted on through such trusts, organizations, etc. is not exempt from tax unless:
    y. The business consists of printing arid publishing of religious books and other materials.
    z. The business accepted on through the trust is wholly for charitable purpose.
    aa. The books of accounts of such business are maintained separately through the trust or institution.

- The income from property held under trust will be exempt from tax only when at least 75% of such income is actually applied to the charitable or religious purposes of the trust in India either throughout the year in which the income is received or in the after that year.
- Though, in case where at least 75% of the income has not been applied for religious or charitable purposes in India throughout the prescribed era but is accumulated or set separately either wholly or in part, the amount of income so accumulated will be exempt from tax provided the accumulation is not planned for a era of more than. 10 years and the trustees have given written notice to Assessment Officer giving details of accumulation: It is also necessary that the accumulated money has to be deposited in Central/State Government securities, post office, savings-bank account, any bank, Unit Trust of India, Industrial Development Bank of India or immovable property etc. Otherwise the income of trust will be taxable.

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

Income of Political Parties — Section 13(A)

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

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

- Income from House Property
- Income from other sources
- Voluntary contribution from any person.

Though, the income shall be exempt subject to the following circumstances:

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

REVIEW QUESTIONS

- What do you mean through exempted income?
- Why sure incomes are exempt?
- What is fully exempted income?
- Talk about the provisions of Income Tax Act dealing with the exemption of income of political parties.
- Explain the provisions of Income Tax Act applicable to Charitable or religious trusts?

PART 2. SALARIES

CHAPTER 5

Salaries-I

STRUCTURE

- Learning objectives
- Meaning of salary
- Main items incorporated in salary
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Describe the term salary
- List the items incorporated under the head salaries
- Explain the provisions of Income Tax Act 1961 in relation to the above items.

MEANING OF SALARY

Any remuneration paid through an employer to an employee for the services rendered through him is described salary. Salary for income tax purposes not only comprises the cash received. It also comprises the value of facilities 'and benefits provided to the employee: The incomes taxable under the head salaries contain

- Any salary due from an employer, or former employer in the previous year, whether paid or not
- Any salary paid o r allowed to an employee in the previous year through or on behalf of an employer though not due or before it becomes due to him.

Some Significant Points Concerning Salary

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

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

Definition

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

- Wages
- Any annuity or pension
- Any gratuity
- Any fees, commissions, perquisites, or profits in lieu of or in addition to any salary or wages.
- Any advance of salary
- any payment received through an employee in respect of any era of leave not availed through him i.e., encashment of leave salary.
- the annual accretion to the recognized provident finance of an employee to the extent provided in the rules. This may take two shapes. Firs) employer's contribution to Provident Finance. Second interest credited on the accumulated balance of recognized provident finance standing to the credit of the employee. As per rules employer's contribution to the P F in excess of 10% of the salary of the employee and the interest credited to the PF accumulations in excess of 12% will be measured as salary. It is important to note that Section 7 deems both the above items as income of the relevant previous year in which the credit has been made.
- Amount of the transferred balance of recognized provident finance to the extent to which it is taxable.

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

- ***Tax-free salary:*** Sometimes the employer deducts the tax at source and pays net salary to the employee. In such cases the individual has to illustrate the aggregate salary i.e., net salary plus tax paid in his gross total income.
- ***Deductions through employment:*** There are sure compulsory deductions from salary like contribution to provident finance or charges for providing accommodation which are deducted through the employer and the net salary is given to the employee. Even though the amount has been deducted, it is incorporated in the salary income. The cause is that it is only the application of income.
- ***Dearness Pay:*** It is a part of vital salary and is assumed to be given under the conditions of employment.
- ***Due date of salary:*** The rules are as follows :
    - bb. For government and semi-government employee the salary is due on first date of after that month i.e., salary for february is due on 1st march. So salary for a previous year 1989-90 will be salary of the month for march 1989 to the salary for the month of february 1990.
    - cc. For employees of bank and non-government organisations the salary is due on last date of similar month i.e., salary for february is due on 28th february so salary income for previous year 1989-90 will be the salary for the month of April 1989 to March 1990.

Definition of Salary for Dissimilar Purposes

The definition of 'salary' differs for dissimilar purposes. The purposes for which the definition of salary would differ contain

- Computation of taxable income under the head salaries.
- Calculating the exempted amount of House rent allowance under Section 10 (13A).

- Calculating the value of rent free accommodation or accommodation provided at a confessional rent.
- Calculating qualifying amount of PF contributions.
- Calculating the entertainment allowance.
- Calculating average deduction under Section 16 (1)
- Calculating exempted gratuity, exempted portion of encashment of earned leave etc.,
- Calculating perquisite value of gas, electricity, or water.
- Determination of salary of Rs. 24,000 concerning taxability of perquisites under Section 17(2) iii (c) (specified employees),
- Compensation under Section 10 (I OB)

Testimonials and Personal Gifts

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

Though, it should be noted that whether a thing of receipt constitutes personal gifts or testimonial in appreciation of meritorious services depends upon the facts of the scrupulous case. Normally speaking, if there is a common scheme of award applicable to all employees after, they complete a scrupulous span of service, such gifts are treated as personal in nature and exempt from tax. Though when there is no such common scheme, and the management awards employees chosen at their own sweet will and pleasure, such payments will constitute salary in the hands of the recipients.

MAIN ITEMS INCORPORATED IN SALARY

Salary or Wages

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

Salary, bonus, commission, or remuneration paid to a partner through the firm is merely an appropriation of firm's profits. Presently because it is described 'salary' through the firm, it cannot become salary in the hands of the partner. It is taxable in the hands of the partner under the head 'Profits and gains of business or professions' and not under the head 'Salaries'. Salary in lieu of resignation notice is chargeable on the foundation of its receipt. V.D, Talwar v CIT (1963) 49 ITR 122 (SC).

Encashment of Earned Leave on Retirement

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

On Retirement

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

Government Employees

In case of Central/State government employees, any amount received as cash equivalent of leave salary in respect of the era of earned leave to his credit at the time of retirement/superannuation is fully exempt. The retirement may be on superannuation i.e., retirement on reaching a specified age or otherwise like termination, voluntary retirement etc. Even if the employee voluntarily resigns from service the exemption will apply CIT V.R.J. Shahney (1966) 159 ITR 160 (Mad).

Other Employees

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

- The amount of leave encashment actually received.
- Leave salary for which the employee is entitled on the foundation of earned leave standing to his credit. This entitlement, to earned leave though cannot exceed 30 days for every year of actual service, 'Salary' for the entitled leave era is to be calculated on the vital of average salary drawn through the employee throughout the era of ten months, immediately preceding the month in which the employee retired. 'Salary' for this purpose means vital salary and comprises dearness allowance if the conditions of employment so give. 11 also comprises commission based on fixed percentage of turnover achieved through an employee as per conditions of contract of employment—Gesletner Duplicators (P) Ltd. v CIT (1979) 177 ITR 1 (SC).
- Salary for 8 months of earned leave era. For this purpose 'salary' has the similar meaning as explained in (b) above.
- Notified monetary ceiling

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

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

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

Cash equivalent of leave salary received through the family of a Government servant who died in harness, is not taxable in the hands of the recipient.

Bonus

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

Pension

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

- Commutation of pension-Section 10 (10A): Where an employee gets a lump sum as a consideration for commutation of his pension, the sum received constitutes salary in his hands, and is taxable. Though Section 10 (10A) gives for sure exemptions.
    dd. Any commuted pension received through a government employee is fully exempt. Also the whole commuted value of pension received through a government servant who voluntarily resigns and joins the services of a public sector corporation is exempt-circular No. 286 dated 17th November, 1980.
    ee. Non-government employees:
        i. In a case where the employee receives gratuity, the commuted value of one-third of the whole pension which he is normally entitled to receive and
        ii. In any other case, the commuted value of one-half of such pension is exempt.

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

Annuity

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

- Annuity payable through the present employer is taxable as salary.

- Annuity received from a past employer is sheltered through Sectionl7 (3) (ii) under any other payment and hence constitutes profits in lieu of salary and is chargeable to tax as salary.
- Annuity from any other person, say from LIC etc., under an insurance policy is taxable as income from other sources.

Gratuity

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

The tax treatment of gratuity is as follows:

- Gratuity paid is taxable as salary. Though, Section 10 (10) gives for sure exemptions. Such exempted portion of gratuity is not to be treated as income.
- Any death cum retirement gratuity received through all categories of central government employees, State government employees or employees of a local authority is fully exempt from income tax.
- Any gratuity received through an employee (whose salary does not exceed Rs. 2500/- p.m.) under the Payment of Gratuity. Act, 1972 is exempt to the extent specified in that Act.

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

- Actual amount of gratuity received
- Rs. 50,000
- Amount of gratuity to which the employee is entitled.

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

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

Any other Employee

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

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

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

'Salary' for this purpose comprises dearness allowance if the conditions of employment so give. It also comprises commission if it is payable under the conditions of employment at a fixed percentage of turnover achieved through the employee. If though the employee paid commission as a percentage of common turnover of the company which is not related to the turnover achieved through the employee such commission is not to be incorporated in salary.

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

Where gratuity is received through an employee from more than one employer, either in the similar year or in dissimilar years, the total amount of gratuity exempt cannot exceed Rs. 1, 00,000/- Since gratuity is taxed as salary, subsistence of connection of employer and employee is vital. For instance the gratuity paid through LIC to its agents does not qualify for any exemption.

Advance Salary

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

Advance against Salaries

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

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

In computing the income of Mr. X for the assessment year 1990-91 the loan of Rs. 10,0001- is not to be incorporated, Though, the salary for April 90 withdrawn through him in March '90 should be incorporated in X's income for the previous year ending 31.3.1990. In other words for the assessment year 1990-91 salary income for 13 months will become taxable in the hands of X.

Though once advance salary is taxed in a scrupulous previous year, it will not be taxed again in the succeeding previous year. This is made clear through the explanation to section 15 which specifically gives that where any salary paid in advance is incorporated in the total income of any person for any previous year it shall not be incorporated again in the total income of the person when the salary becomes due.

Relief

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

Allowances

Allowance means cash received separately from the salary. All kinds of allowances like dearness allowance, city compensatory allowance, children's education allowance etc., through whatever name described are taxable as salaries even though they have not been specifically incorporated in the definition.

Now-a-days there is a rising practice through many companies to provide such allowances as conveyance allowance, education allowance etc., as voucher payments. In other word the vouchers are so worded that the payments constitute reimbursements towards expenditure actually incurred. The quantum of allowance for each employee in excess of an era of say one year remnants constant. Such payments clearly constitute 'salary' in the hands of the recipient.

The allowances may be fully taxable, partially taxable, or fully exempted. Chart 5.1 provides the list of these three kinds of allowances.

Chart 5.1 Allowances

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

Let us now talk about Partially Exempted Allowances one through one. Fully taxable and fully exempted allowances do not require further elaboration.

- Mouse Rent Allowance; Section 10(13A): Usually employees are paid house rent allowance through their employers to meet the expenditure incurred through them towards house rent. Under Section 10(13A) read with Rule 2A such house rent allowance is exempt from tax subject to the following limits.
    - ff. The actual amount of HRA received in respect of the era throughout which the house was occupied through the employee throughout the previous year (relevant era) or
    - gg. Excess of rent paid through the employee in excess of 10% of salary due to him in respect of the relevant era.

- 'Salary' for this purpose comprises dearness allowance if the conditions of employment so give but excludes all other allowances and perquisites. In comprises commission if it is payable under the conditions of employment at a fixed percentage of turnover achieved through the employee, or
- 50% of salary due to the employee in respect of the relevant era, where such accommodation is situated at Bombay, Calcutta, Delhi and Madras and 40% of salary due to the employee in respect of relevant era, where such accommodation is situated at any other lay.

The least of the three is exempt.

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

Entertainment Allowance

Entertainment allowance is part and parcel of salary income and it is chargeable to tax. Though it is practical information that employees to whom such allowance is granted spend a considerable portion thereof on entertaining customers to improve the business prospects of their employer. Realizing this situation, the Act has allowed a statutory deduction in respect of entertainment allowance.

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

- Composite Hill compensatory allowance or High Altitude allowance or uncongenial climate allowance or illustrate bound area allowance or Avalanche allowance.
- The prescribed limits are Rs. 600/-, Rs. 1200/- or Rs. 150/- per month depending upon the regions.
- Border area allowance or remote area allowance or hard area allowance or disturbed area allowance.
- The prescribed limits are Rs. 650/-, Rs. 525/-, Rs. 375/-, Rs. 300/- or Rs. 100/- per month depending on regions.

Tribal allowance

- This exemption is accessible @ Rs. 100/- per month in nine States:
    hh. Madhya Pradesh
    ii. Tamil Nadu
    jj. Uttar Pradesh
    kk. Karnataka
    ll. Tripura
    mm. Assam
    nn. West Bengal
    oo. Bihar and
    pp. Orissa.
- Any allowance granted to an employee working in any transport system to meet his personal expenditure throughout his duty performed in the course of running of such transport from one lay to another lay is exempt up to a specified limit. The specified limit is 70% of such allowance or Rs, 1000/- p.m., whichever is less.
- Children educational allowance—Rs. 50/- per month per child up to a maximum of two children.
- Hostel Allowance: Any allowance granted to an employee to meet the hostel expenditure on his child Rs. 150/- p.m. per child up to a maximum of two children.

'Profits' in Lieu of Salary

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

- ***Compensation received through an employee on termination of his employment or on modification of his conditions of employment:*** Compensation is basically a capital receipt since it supplants the very source of income i.e., the salary. Capital receipts are not taxable unless through definition they are treated as income. In the present case the termination compensation is specifically treated as profit in lieu of salary. Profits in lieu of salary, as we know are treated as salary through definition. Hence such compensation is taxable as salary. Some times the conditions and circumstances of employment may be customized to give that in future the employer will get lower salaries in lieu of which they will be paid immediately a lump sum consideration. Such payment is taxable as salary.
- ***Payments from unrecognized finance:*** Any payment received through an assessee from an unrecognized provident finance or other finance (not being approved superannuation finance) to the extent it consists of employer's contribution and interest thereon is taxable as profits in lieu of salary. Interest on the employee's contribution to an unrecognized provident finance is chargeable to tax as "income from other sources". Employee's contribution though is taxed' year to year.
- ***Any other payments:*** Any other payments made through an employer or a former employer is incorporated in profits in lieu of salary. Where an employer provides to his employee any sum through method of personal gift and not an appreciation of his services, it is not taxable.

Specific Exemptions

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

- Exempted gratuity — (Section 10(10)
- Exempted value of commuted pension—Section 10 (10 A)
- Exempted amount of retrenchment compensation—Section 10 (10 B).
- Compensation received through public sector employee on voluntary retirement— Section 10 (10C)
- Payment from statutory provident finance—Section 10 (11).
- Exempted amount of accumulated balance (under Rule 8 of Part A of IV Schedule) from recognized provident finance—Section 10 (12).
- Payment from Approved Superannuation finance—Section 10 (13)

REVIEW QUESTIONS

- What is the meaning of term salary as per Sections 15 and 16 of Income Tax Act 19611 ,
- What are the provisions of Income Tax Act concerning commutation of pension?
- What do you mean through 'profits in lieu of salary'?

CHAPTER 6

Salaries—II

STRUCTURE

- Learning objectives
- Perquisites
- Valuation of perquisites —all employees
- Valuation of perquisites-specified employees
- Fully exempted perquisites
- Deductions from salaries
- Review questions

LEARNING OBJECTIVES

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

- Describe the term 'perquisite'
- List dissimilar kinds of perquisites made accessible to salaried employees
- Compute the value of such perquisites
- Explain statutory deductions accessible to a salaried employee.

PERQUISITES

Perquisites are payment, fees, or profits attached to an office. They are made accessible to employees in addition to normal salary or wages. Perquisites may be either in cash or in type, normally though, they are in the form of facilities in type.

The vital concept underlying taxation of perquisites is that it results in a personal advantage to the recipient. For instance, if an employee is provided through his employer with a motor-car which is used exclusively through the former in the discharge of his official duties only, then there is no perquisite involved. When the similar is utilized partly for official purposes and partly for personal purposes, then, the value relating to personal use only is taxable. If the similar is used exclusively for personal purposes, then, the whole value is taxable as a perquisite. Therefore it is clear that reimbursement of traveling expenses to employees for carrying out official duties is not taxable as perquisite in the hands of the employees.

You know that 'perquisite' is a component of salary income. It follows so, that there should exist employer-employee connection before a thing of perquisite can be brought to tax as salary. The value of any perquisite to a person, not arising out of employer-employee connection is taxable as 'income from other sources'.

Therefore tips received through waiters from customers are taxable as 'income from other sources’. It is significant that the advantage arising to the employee should have a legal foundation. Any unauthorized advantage taken through the employee would not amount to a benefit or advantage. Suppose A Ltd., allots a bungalow to one of its common managers. Subsequently he resigns from the company. Though, he continues to live in the company's bungalow for a year after which he was evicted from the premises through legal proceedings. Now the question arises as to whether any perquisite arises in the hands of the common manager the value of which would be charged as salary in his hands.

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

Definition of Perquisites

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

- ***Rent-free accommodation provided to the employee through his employer— Section 17(2) (i):*** The value of this perquisite is to be calculated as prescribed through Rule 3 and is to be incorporated in the taxable salary of all employees—whether their salary is below Rs. 24,0001- or not.
- ***Accommodation at a confessional rent—Section 17(2Xii):*** Several a times employers give accommodation to their employees at confessional rent i.e., where the market rent for the similar is much higher than what the employer charges from his employee. The value of concession is treated as a perquisite and is to be incorporated in the taxable salary of all employees irrespective of the information that their salary exceeds Rs. 24,000 or not.
- ***The value of any benefit or amenity to specified employees — Section 17(2) (iii):*** Separately from accommodation free of rent or at confessional rent the value of which is to be incorporated in the taxable salary of all the concerned employees without exception, there are several other benefits or amenities provided through the employers to their employees either free of cost or at confessional price. Free motor-car, gas, electricity, water, domestic servant, sweeper, gardener, free education etc., are some examples in this regard. The value of these perquisites is to be incorporated in the taxable salary of employees only under specified circumstances. These are :
- ***Through a company to an employee who is director thereof:*** Where these benefits are provided through a company to its director who is an employee the value of such benefits is to be always incorporated in the taxable salary of the director whether his salary is below Rs. 24,000/- or not. If the director is not an employee of the company, the value of the benefits should be taxed in his hands as 'income from other sources'. It should be clearly noted here that while defining 'income' Section 2(24) (iv) comprises the value of any benefit obtained from a company through a director, whether ha is an employee or not. Though, for the purpose of valuing such benefits we cannot apply Rule 3 of the I.T. Rules, 1962 since they are specifically meant for valuation

of perquisites provided to employees. It is logical, so, to opine that a value which is fair according to the opinion of the Assessing Officer is to be assigned to the perquisite and taxed in the hands of the director as income from other sources.

- ***Through a company to an employee who has a substantial interest:*** Where the benefits are provided through a company to its employee who has a substantial interest in the company the value thereof is always to he incorporated in his taxable salary whether he is drawing below Rs. 24,0001- or not. According to Section 2(32) where an employee of the company is the beneficial owner of equity shares carrying not less than 20% of the voting power he is deemed to be an employee who has a substantial interest in the company. Where such person is not an employee of the company, the observations made earlier in connection with a director as to the valuation of such a perquisite and the head under which it is to be charged will equally apply here.
- ***All other employers whose income under head salaries exceeds Rs. 24,000:*** All employees, other than directors and employees considerably interested in a company, whose monetary income under the head 'Salaries' exceeds Rs. 24, 0001- will be taxed in respect of the value of any benefit or amenity granted free or at a confessional rate through their employers. If the monetary income does not exceed Rs. 24, 0001- the value of such benefits is not taxable in their hands.
- ***Calculation of Monetary income for determining specified employee:*** First of all add all taxable monetary payments like salary, D.A., bonus, commission, fee, advance salary, salary arrears, pension, unexampled house rent allowance, taxahle gratuity, profits in lieu of salary, annual accretion to the credit balance of the employee under recognized provident finance, taxable transferred balance of recognized provident finance, all taxable allowances etc.. From the above amount we have to deduct the permissible deductions like average deduction, entertainment allowance and profession tax. A question arises here whether income under the head 'Salaries' as specified in Section

17(2)(iii) is income before or after allowing the above three deductions. The logical view appears to be that we have to provide full effect to all the sections under a scrupulous head of income before we can arrive at the income from that head. Hence the deduction permissible under Section 16 has to be excluded. Where an employee is serving with more than one employer, monetary payments made through all employers should be added up. Thereafter, the deductions under Section 16 should be allowed. If the balance exceeds Rs, 24,000/- the employee is to be treated as a specified employee.

- ***Obligation of the employee paid or reimbursed through the employer-Section 17(2) (iv):*** Where the employer pays or reimburses any amount to an employee towards an obligation which, if the employer had not made the payment, the employee would himself discharge will constitute a perquisite chargeable to tax in the case of all employees whether drawing a salary of Rs. 24,000/- or less. Here we have to cautiously distinguish flanked by two things.
  - qq. An obligation which the employee himself will certainly discharge even if the employer does not pay or reimburse.
  - rr. A benefit which the employee himself does not want but keeps on the insistence of the employer.
- ***Examples of the first diversity would contain:*** Payment or reimbursement of educational expenses, electricity bills, debts of the employee, income tax dues of the employee etc. Though where an employee becomes a member of a club to further the business prospects of his employer then reimbursement of such club bills cannot be taxed under this clause because the employee through himself would not have incurred the expenditure. Even if he derives any personal advantage from such membership the value thereof will be taxable as a perquisite under clause 17(2) (iii) and not under 17(2) (iv). The similar principle applies where the employee, on the instructions of his employer, keeps a gardener, pays him wages, and gets reimbursement of such wages.

- ***<u>Any, sum payable through the employer to effect an assurance on the life of the assessee or to effect a contract for an annuity: Section 17(2) (v).</u>***: An employer can choose to effect an assurance on the one of the employee. Alternatively he can effect a contract of annuity with the LIC or an outside agency to enable his employee to get a regular sum after retirement. The payments towards the premium or the annuity contract can either be made directly or through finance specifically created for this purpose. Under both the cases the payments are to be taxed as perquisites in the hands of the employee. Though if the above payments are made through the following funds, they are not to, be treated as perquisites.
    - ss. A recognized provident finance.
    - tt. Approved superannuation finance.
    - uu. A Deposit Connected Insurance Finance recognized under Section 3G of the Coal Mines Provident Finance and Miscellaneous Provisions Act, 1948 or the Employees Provident Funds and Miscellaneous Provisions Act, 1952.

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

Kinds of Perquisites

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

- Perquisites taxable for all categories of employees
- Perquisites taxable for specified employees
- Tax-free Perquisites.

A. Perquisites Taxable for all Categories of Employees:

- Rent-free house provided through the employer.
- House provided at confessional rent.
- Any payment made or obligation discharged through the employer in respect of such obligation of the employee which, but for such payment would have been made through the employee himself e.g., payment of club or hotel bills, salary of domestic servant, educational expenses of children of the employee, loan, income tax, etc.
- Any sum paid or payable through the employer in respect of insurance premia on the life of the employee, When an assessee (employee of foreign company) is deputed to supervise erection work in India, and is provided with rent-free accommodation, provision of which is necessary for discharge of his official duty, it will not be treated as a perquisite.

B. Perquisites Taxable for Specified Employees

- Motor Car
- Gas, electricity and water
- Transport
- Free education to employee's children in employer's institution
- Sweeper, watchman, gardener, etc.
- Refrigerator, heater, etc.
- Facilities of free boarding and lodging at Holiday Homes
- Issue of shares at a concessional price
- Free lunch.

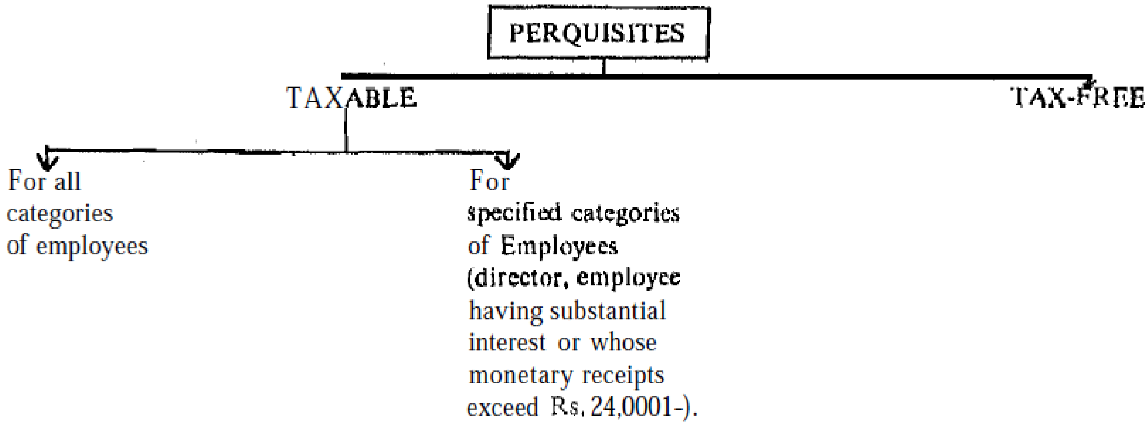
C. ax-free Perquisites for all Categories of Employees

- Medical benefits. The reimbursement of medical expenses or provision of medical facilities will be taxable only in excess of Rs. 5,000 p.a. (Circular No. 376 dated 6.1.1984.) Though, medical facilities free of charge or reimbursement of medical expenses such as, operation fees, hospitalization charges and cost of medicines, tests, etc. actually incurred in India through the employer on an employee, including

Managers/ Directors, and his family members will not be treated as perquisite provided this expenditure is incurred on medical treatment in a recognized public hospital in India.

- Refreshment throughout working hours in office premises.
- Free telephone at the residence of the employee even though it is partly used for private purposes.
- subsidized lunch or dinner provided throughout working hours.
- Recreational facilities.
- Amount spent through the employer on refresher course training of the employees.
- Goods sold through the employer to his employees at concessional rates.
- Conveyance facility to employees from their residence to office and vice versa.
- Free travel passes issued through Railways to its employees and their family members.
- Leave travel concession-Subject to a limit.
- Employer's contribution to staff group insurance scheme.
- Perquisites allowed outside India through the Government to its employees who are rendering services outside India.
- Value of free rations given to the armed forces personnel.
- Value of the facilities of promoting family scheduling in the middle of the employees.
- Value of rent-free official residence, conveyance facilities, and sumptuary allowance provided to the High Court and Supreme Court judges.
- Value of rent-free furnished residence (including maintenance thereof) provided to a Minister, an Officer of Parliament, or a Leader of the Opposition in Parliament.
- Scholarship given through the employer to children of the staff members is not a perquisite to the employees. If it is treated as a perquisite, it is exempt u/s 10(6).

Chart 6.1 . THE CLASSIFICATION WILL RE MORE CLEAR WITH THE HELP OF THE FOLLOWING



VALUATION OF PERQUISITES —ALL EMPLOYEES

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

Rent Free Accommodation—Rule 3(a)

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

- Government Employees
- Semi-Government Employees
- Employees of Private Sector
- ***Government Employees:*** The following kinds of employees are incorporated in this category:

    vv. Central and State Government employees.

ww. Government officials who have been deputed to a body or undertaking under the control if the Government, occupying residential accommodation allotted to that body or undertaking through the Government.

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

Add 10% per annum of the original cost of the furniture (including television sets, refrigerators, other household appliances and air-conditioning plant or equipment). The value of rent-free residence provided to the following persons is totally exempt from income tax.

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

Accommodation at Concessional Rent—Rule 3(B)

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

VALUATION OF PERQUISITES-SPECIFIED EMPLOYEES

There are sure perquisites which are taxable in case of specified employees, i.e. directors of a company, person having substantial interest in the company or a person whose monetary salary exceeds Ws. 24,000/-.

Motor Gar

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

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

Free Lodging and Boarding to Hotel Employees

It is general practice for modem hotels to provide free board and lodging to employees whose services is necessary on a continuous foundation. The value of such free boarding and lodging is to be determined as under:

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

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

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

- ***When it is chargeable under Section 17(2) (iii) us a perquisite:*** Where the supply connection for these facilities is in the name of the employer, any payment through the employer for these facilities for the benefit of the employees is a perquisite taxable only in the hands of specified employees.

- ***<u>When it is chargeable under Section 17(2) (iv) us an obligation met:</u>*** Where the supply connection for gas/electricity/ water is in the name of the employee and the bills thereof are paid or reimbursed through the employer it is an obligation of the employee met through the employer. Such payment or reimbursement is taxable in the hands of all employees.
- ***<u>Valuation :</u>*** The taxable perquisite under Section 17(2)(iii) is to be valued as follows:
  - xx. Where such supply is made from possessions owned through the employer without purchasing them from any other outside agency, the value thereof is taken to be nil. For instance if Indian Oil Corporation gives free gas supply to its employees the perquisite thereof is nil.
  - yy. Where the supply is made through an outside agency, the amount paid through the employer to such agency is the perquisite value.
  - zz. Where the Assessing Officer is satisfied that the gas, electric power or water supply to the employee are also consumed for the purposes of his official duties. the value of the perquisite is taken (a) either, the amount paid on that account through the employer to the agency supplying the gas, electric power or water or (b) an amount equal to 6 1/4% of salary whichever is less, "Salary" for this purpose has not been defined. We may though follow the rule that salary comprises vital pay plus dearness allowance if it is Measured for calculating superannuation benefits. Commission paid at a fixed percentage of turnover achieved through the employee can also be incorporated vide Gestener Duplicator (P) Ltd., v. C.I.T. (1979) 117 ITR 1 (S.C.).

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

Free Education—Rule 3(e)

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

- The employer can run the educational institution through himself for the benefit of all his employees as a group. It is not necessary that such institution should be run for the exclusive benefit of the employees' children. Outside children can of course be admitted. This results in a perquisite taxable in the hands of the employee. The value should be determined with reference to the cost of such education to the other students learning in that institution. If, though, such institution is run exclusively for the benefit of employees' children only than the value of the perquisite will be equal to the cost of such education in a similar institution in or close to the locality. It should be noted that the value of this perquisite is chargeable in the hands of specified employees only.
- The employer may pay the amount of fees directly to the concerned educational institution, or, he may reimburse his employee. The actual expenditure so incurred through the employer is taken as the value of the perquisite. This value being an obligation met is to be incorporated in the salary of both specified and non-specified employees.
- Scholarship: Where any scholarship is paid through an employer to any child of an employee, the scholarship so paid to the child cannot be treated as perquisite to the employee—C.I.T. v. M.N. Nadkarni (1986) 161 ITR 544 (Bom).
- Education to Employees: Amount spent on free education and training of employees is not taxable as a perquisite.
- Education allowance: Fixed education allowance paid to employees to meet the cost of education of his family members is taxable in all

cases. Though notified exemption under Section 10(14) can be claimed.

Conveyance Facility through Transport Undertaking—Rule 3(f)

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

Free Sweeper, Watchman, Gardener, etc.

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

Note: Where the employee engages the services and where the employee engages the SERVICES-DISTINCTION in taxability.

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

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

Medical Benefits

- ***Not taxable at all:*** Provision of medical facilities or reimbursement of actual medical expenses through the employer for the treatment of employee including Manager (Director) or the members of his family in a recognized public hospital under CGHS and CS(MA) in India is not to be treated as a perquisite. There is no monetary limit in this regard. Though the Assessing Officer will look at the genuineness of the expenditure at the time of assessment—Circular No. 445 dated December 31, 1985.
- ***Taxable beyond Rs. 5,000/- :*** In the case of any other, hospital the exemption limit is one month salary of the employee or Rs. 5,000/- whichever is higher.

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

Other Perquisites

- ***Holiday home for employees:*** Where an employer maintains holiday homes for his employees with boarding, lodging, and transport facilities, it is a taxable perquisite only in the hands of specified employees under Section 17(2) (iii). The value thereof cannot be arbitrarily fixed. Factors like excellence, site, and extent of accommodation, era of stay, other linked facilities, and cost of getting similar facilities from outside sources should be duly measured.

- ***Sale of assets through the employer to the employee not concessional rates:*** Where the employer sells any asset to the employee at concessional rate, the value of such concession is taxable in the hands of specified employee under Section 7(2) (iii). Though recently views have been expressed that where a company sells an asset like a car, air conditioner etc. to its employees at their book value, while the market rate may be higher, no perquisite is involved since it is purely a commercial transaction flanked by the parties at an agreed price.
- ***Interest free loan to employer:*** If an employer grants interest free loan to any employee, the cost to the employer for arranging such a benefit is a taxable perquisite In the hands of specified employees under Section 17(2) (iii). Therefore where the employer borrows money from outside and provides the similar interest free to his employee the amount of interest payable through the employer thereon is the taxable value of the perquisite. Where the loan is advanced to the employee out of the employer's own funds, a reasonable sum of interest which the employer has to pay on such amount will be taken to be the perquisite value. Though the above perquisite is chargeable in the hands of specified employees only...
- ***Shares issued at concessional rates:*** Where shares are issued through a company to its employees at concessional rates, the value of the concession is a taxable perquisite in the hands of specified employees under Section 17(2) (iii).
- ***Any other benefit or amenity—Rule 3(g):*** The value of any other benefit or amenity is to be determined on such foundation and in such amount as the. Assessing Officer considers fair and reasonable.

FULLY EXEMPTED PERQUISITES

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

- ***Premium paid on personal accident policy:*** Where an employer pays a premium on a personal accident policy taken through him on the life of the employee, the payment is not a perquisite. It is because the employee has not voluntarily taken the insurance policy and the employee has no vested interest in the policy — CIT v Lala Shri Dhar (1971) 84 ITR 192.
- ***Recreational Facilities:*** Provision of recreational facilities through an employer to groups of employees is exempt, from tax. Though, the facility should be made accessible in common. and should not be restricted to a few employees. If so restricted, the value thereof is taxable as a perquisite in the hands of specified employees under Section 17(2) (iii).
- ***Refreshment throughout office hours:*** Provision of refreshments' like coffee, tea, cold drinks, snacks etc., to the employees throughout office hours in the office premises is exempt from tax. The value of subsidized lunch or dinner provided to employees is also exempt. But free lunches are taxable in the hands of specified employees.
- ***Residential Telephone:*** Where an employer gives a telephone connection to the employee for official use, the payment of telephone bills does not constitute a perquisite in the hands of the employee, even if he uses the telephone for personal purposes also. The logic behind this is that it is hard for the Assessing Officer to segregate personal and official calls.
- ***Perquisites to government employees posted abroad—Sec. 10(7):*** Perquisites paid or allowed outside India through the government to a citizen of India for rendering service outside India are fully exempt from income tax.
- ***Fees paid for refresher courses:*** Expenditure incurred through an employer for providing training to an employee in new management techniques or for improving his knowledge to discharge his official functions in a better method or for sponsoring him for any refresher course or for attending any seminar linked with the business of the

employer is not a taxable perquisite even if such expenditure comprises boarding and lodging expenses of the employee.

- ***Leave Travel Concession—Section 10(5) read with Rule 2B.:*** An employee, whether he is a citizen of India or not is fully exempt from tax in respect of the value of leave travel concession provided to him through his employer. The extent of exemption is specified in Rule 2 B. which says. The value of any leave travel concession or assistance received through or due to an individual

  aaa. From his employer for himself and his family in connection with his proceeding on leave to any lay in India is exempt; and

  bbb. From his employer or former employer for himself and his family, in connection with his proceeding to any lay in India after retirement from service or after the termination of his service, is exempt.

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

Further the amount exempt under this clause shall in no case exceed the amount of expenses actually incurred for the purpose of such travel, Explanation. In this clause the word 'family' means:

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

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

Circumstances Prescribed under Rule 2B

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

- Where the journey is performed through rail, an amount not exceeding the air-conditioned second class rail fare through the 'shortest route;
- Where the spaces of origin of journey and destination are linked through rail but the journey is performed through any other mode of transport an amount not exceeding the air-conditioned second class rail fare through shortest route;   Where the spaces of origin of journey and destination or part thereof are not linked through rail and the journey is performed flanked by such spaces, the amount eligible for exemption shall be—
  - ccc. Where a recognized public transport system exists, an amount not exceeding the first class or deluxe class fare, on such transport through the shortest route; and
  - ddd. Where no recognized public transport system exists, an amount equivalent to the air-conditioned second class rail fare through the shortest route, as if the journey had been performed through rail.

DEDUCTIONS FROM SALARIES

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

- Average Deduction
- Entertainment Allowance
- Tax on Employment

Average Deduction —Section 16(i)

- With effect from 1990-91 assessment year the average deduction will be equal to 33 1/3% of salary or Rs. 12,000/- whichever is less.
- 'Salary' for the above purpose has been defined in Section 17(1). It comprises all monetary payments and all perquisites.
- Even if the employer gives conveyance facility to the employee for personal purposes there will be no restriction on the amount of average deduction.
- Where an employee receives salary from more than one employer, average deduction is to be computed with reference to the aggregate salary due, paid, or allowed to the assessee through all the employers. In no case can it exceed the ceiling limit of 33 1/3% or Rs. 12,000/- whichever is less.
- Average deduction is accessible to pensioners also.

Entertainment Allowance—Section 16(ii)

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

- ***Government employee:*** The least of the following will be allowed as a deduction :

  eee. RS. 5,000

  fff. 1/5TH OF THE SALARY

  ggg. Amount of entertainment allowance granted throughout the year.

- ***Non-government employee (including semi Government employee):*** The deduction for entertainment allowance is accessible to those non-government employees who satisfy the following two circumstances:

  hhh. The employee necessity have been in continuous service with the present employer from a' date prior to 1.4.1955.

iii. His necessity has been getting entertainment allowance from his present employer continuously from a date before 1.4,55 till the relevant previous year.

If an employee does not satisfy both the circumstances, entertainment allowance is fully taxable. If both the circumstances are satisfied the least of the following is allowed as a deduction:

- Rs. 7,500/-
- Rs. 20% of salary

- Amount of entertainment allowance granted throughout the relevant previous year or
- Amount of entertainment allowance received throughout the financial year 1954-55.

'Salary' for this purpose excludes any allowance, benefit or other perquisites. It may be noted that the prescribed deduction will be accessible even if the entertainment allowance received is not actually spent or spent for purposes other than entertainment of customers.

REVIEW QUESTIONS

- What do you mean through a 'perquisite' and what does it contain?
- What is not incorporated in 'salary' for calculating the value of rent-free accommodation for a public employee?
- What are provisions of Section 16(ii) concerning entertainment allowance received through a non-govt. employee?

CHAPTER 7

Salaries—III

STRUCTURE

- Learning objectives
- Provident finance scheme
- Tax treatment of provident finance
- Sure other characteristics of taxable salary
- Deduction under section 80c
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to

- List dissimilar kinds of provident funds and their treatment for tax purposes.
- Enumerate and calculate the amount of deductions accessible u/s 80C compute the taxable income from salary after taking into account the P.F. and deduction u/ s 80C

PROVIDENT FINANCE SCHEME

Provident Finance is a finance which is created to help an individual in future, i.e., after retirement or death. The employee contributes a sure amount every month out of his salary an equal amount is contributed through the employee. This amount is invested in government securities and earns a sure amount of interest. The interest so earned on the balance standing in the account of the employee is credited to his provident finance account. This amount gets accumulated in excess of an era of time. The whole amount accumulated in excess of years is given to the employee at the time of retirement or voluntary retirement and is paid to the legal heir after the death of the employee. There are dissimilar types of provident funds. The employee can deposit the amount in any of the provident funds. The dissimilar types of Provident Funds are:

- Statutory Provident finance
- Recognized Provident Finance
- Unrecognized Provident Finance
- Public Provident Finance
- Approved Superannuation Finance

Statutory Provident Finance

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

Recognized Provident Finance

This is a provident finance which is recognized through the commissioner of Income Tax in accordance with the rules contained in part A of the Fourth Schedule to the Income Tax Act 1961. It comprises a provident finance recognized under a scheme framed under the Employees Provident Finance Act, 1952. It necessity be remembered that it is significant for tax purposes. For instance where a provident finance is recognized through the PF commissioner but not through the commissioner of Income Tax, then the tax concessions under the Income Tax Act cannot be extended to the contributions to such provident finance.

Unrecognized Provident Finance

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

Public Provident Finance (PPF)

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

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

Approved Superannuation Finance

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

TAX TREATMENT OF PROVIDENT FINANCE

In Section 72 you studied the dissimilar types of provident funds. Let us now revise several provisions of Income Tax Act 1961 with regard to these funds. The Income Tax Act lays down provision for

- Employers contribution
- His own contribution
- Interest on accumulated,
- Deduction u/s 80c and
- Tax liability of accumulated balance payable.

SURE OTHER CHARACTERISTICS OF TAXABLE SALARY

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

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

DEDUCTION UNDER SECTION 80C

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

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

Amount 3) Amount of deduction.

Gross Qualifying Amount

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

- LIC premium paid through an individual to effect or to stay in force insurance on his own life, life of 'spouse or any child. Though, any premium paid in excess of 10% of sum assured will not qualify for deduction. Such excess is to be ignored for the purpose of computation. Payment made through the Government employees to the Central Government Employees Insurance scheme is also to be incorporated for the purpose. Though, where an assessee discontinues a policy of life insurance before premiums for two years have been paid no deduction will be allowed in respect of the premiums paid in the year in which the policy is terminated. Further, the amount of deduction allowed in respect of the premiums paid in the preceding year or years is deemed to be the income of the assessee of such preceding year or years and shall be taxed accordingly. For this purpose, the deduction allowed in respect of the premiums pad in any previous year or years is the variation flanked by the amount through which the total deduction actually allowed under this section for that relevant year exceeds the deduction which would have been allowed if no such premium had been paid in that year.
- Payment through individual in respect of incommutably deferred annuity of his own life, life of the spouse or any child. It has been clarified that contribution for annuity plans under Section 80CCA i.e., Jeevan Dhara and Jeevan Akshay Policies do not qualify for deduction under Section 80C.
- Contribution made towards Statutory Provident Finance qualifies fully. Contribution made to recognized provident finance qualifies subject to the maximum limit of 1/5 of the salary. Salary for this purpose

comprises Dearness Allowance if the conditions of employment so give but excludes all other allowances and perquisites. If, though, under the conditions of contract of employment, commission is determined at a fixed percentage of turnover achieved through' an employee such commission can be incorporated in salary. Contribution to approved superannuation finance qualifies fully. Contribution to an unrecognized provident finance does not qualify.

- Contribution to the Public provident finance, subject to a minimum of Rs. 100 and a maximum of Rs. 60,000.
- Contribution for participating in the 'Unit-connected insurance plan.
- Contribution to Unit Connected Plan of the LIC Mutual Finance.
- Amount deposited in a 10-year account under post office savings bank.
- Subscription to National Savings Certificates VIII since. Up to 1989-90 assessment year subscription to 6-year National Savings Certificates VI and VII issues qualified for deduction. The sale of the above certificates has been discontinued after March 31, 1989, Though; interest on NSC VI issued purchased up to 31.3.89 is to be incorporated in the qualifying amount.
- Payment for the construction of residential house. Any specified payment subject to a maximum of Rs. 10,000 for the purchase or construction of a residential house, the construction of which is completed after March 31, 1987 and the income from which is chargeable under the head 'Income from house property' will qualify for inclusion in the qualifying amount. If the house is not completed throughout the relevant previous year no deduction will be allowed.

The following are the specified payments in this regard:

- Any installment payment or part payment of the amount due under self-financing or other schemes of any development authority, housing boards etc. occupied in the construction and the sale of house property on ownership foundation.

- Any installment payment or part payment of the amount due to any company or co-operative society of which the assessee is a shareholder or member towards the cost of the house allotted to him.
- Repayment of the loan borrowed through the assessee from :
    - jjj. The Central Government or any State Government or
    - kkk. Any bank including a co-operative bank or
    - lll. The Life Insurance Corporation or
    - mmm. Any public company shaped and registered in India with the main substance of carrying on the business of providing extensive-term finance for the construction or purchase of houses in India for residential purposes and which is approved for creating special reserve under Section 36(i)(viii) or
    - nnn. Any company in which the public are considerably interested or any cooperative society where such company or society is occupied in the business of financing the construction of houses or
    - ooo. The employer of the assessee, where such employer is a public company or
    - ppp. Public sector company or
    - qqq. University in its affiliated college or
    - rrr. A local authority or
    - sss. National Housing Bank
- Any payment of stamp duty, registration fee and other expenses for the purpose of the transfer of such house property to the assessee.

Ineligible Payments

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

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

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

- Any money paid in the relevant previous year in which the refund is received will not qualify for being measured for deduction under Section 80C.
- The total amount of the deductions allowed in the previous years preceding the relevant previous year will be deemed to be the income of the assessee of the relevant previous year in which such refund has been received. Such income will be chargeable as income from other sources. Where the house property so acquired is transferred through the assessee before the expiry of 5 years from the end of the financial year in which possession of such property is obtained through him, the two tax effects as explained above will follow.

Deposit with National Housing Bank

Any deposit made in the Home Loan Account Scheme of the National Housing Bank qualifies for deduction under Section 80C. If we add up all the above qualifying amounts as explained in 1 to 10; the total will constitute the gross qualifying amounts as explained in 1 to 10, the total will constitute the gross qualifying amount.

Net Qualifying' Amount

The whole gross qualifying amount cannot be measured as eligible for deduction. The act gives upper limits in respect of the qualifying amounts. They are as follows:

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

Amount of Deduction

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

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

System of Rebate from Assessment Year 1991-92

The Finance Act 1990 has replaced the existing system of allowing deduction from gross total income under Section 80C with a new system of allowing a rebate which will be deducted from the tax payable through the assessee on his total income. The rebate allowable is at the rate of 20% of the qualifying amount. The method of ascertaining the qualifying amount is the similar. The items of approved savings also remain the similar except for the information that the ceiling limit of 1/5 of the salary in respect of contribution to recognized provident finance has been removed.

The deduction through method of rebate of tax cannot exceed the following limits:

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

REVIEW QUESTIONS

- What are the provisions of Income Tax Act 1961 concerning the Unrecognized Provident Finance?
- What payments are not eligible to qualify for deductions in rise of payment of loan taken for construction of a house?

PART 3. OTHER HEADS OF INCOME

CHAPTER 8

Income from House Property

STRUCTURE

- Learning objectives
- Income from house property
- Income from house property exempt from tax
- Some significant points
- Annual value
- Computation of annual value
- Deductions from annual value
- Review questions

LEARNING OBJECTIVES

After learning this chapter you should be able to

- List the incomes chargeable under the head house property
- List the exempted income from house property
- Determine the annual value of house property of dissimilar categories

INCOME FROM HOUSE PROPERTY

According to Section 22 of Income Tax Act, 1961 the assessee has to pay tax on annual value of the property:

- Which consists of any buildings or lands appurtenant thereto
- Which is owned through the assesses, and
- Which is not used for purposes, of assessee’s business or profession?

Buildings or Lands Appurtenant Thereto

House property means buildings or land appurtenant thereto, and the income from such house properly is chargeable under the head income from house property. The word 'structure' has not been defined through the Act. On the foundation of judicial decisions, though, the term structure is wide enough to contain residential houses, warehouses, auditoriums for entertainment programmes, cinema halls, buildings let out for office use, stadium, open air theatre, dance hall, music halls and lecture halls. Temporary hutments on vacant land are not incorporated in buildings and any income from such hutments is taxable under the head income from other sources. Land appurtenant to structure contains compound, play ground, kitchen-garden, court yard etc. Land which is not appurtenant to any structure does not become house property for the purposes of income tax. That means any rental income from land which is vacant and not attached to structure is not chargeable under the head income from house property.

Another point which is to be noted is that the site of the structure is immaterial. It may be situated in India or abroad; but the income from buildings is taxable under this head of income. Though, there are sure exceptions.

Exceptions

- Structure or staff quarters let out to employees and others: Where the assessee lets out the structure or staff quarters to the employees of business whose residence there is necessary for the efficient conduct of business, the rental income from such employees is not taxable as income from house property.
- Structure let out for locating bank, post office, police station etc.: If structure is let out to authorities for locating bank, post office, police station, central excise office, etc. such an income will be assessable as income from business provided the dominant purpose of letting out the

structure is to enable the assessee to carry on his business more efficiently and smoothly.

- Composite letting of structure with other assets: Where the assessee lets on hire machinery, plant or furniture belonging to him and also buildings for a composite rent, and the rent of the buildings is inseparable from the rent of the said machinery, plant or the furniture, the income from such letting is chargeable to income tax under the head 'Income from 'Other Sources' or under the head 'Business or Profession', if such letting is his business.
- Paying-guest accommodation: It is assessable as business income.

Assessee to Pay Tax on Annual Value

Another significant point concerning income from house property is that it is the annual value and not the rental value which is put to tax. Annual value is calculated through creation sure deductions from the rental value, reasonable rent, or municipal rent.

The Assessee should be the Owner of the House Property

In order that a house property may be termed as house property under this head of income, it is necessary that the assessee should be the owner of the house property. It is the legal ownership and not the beneficial ownership. He may or may not be the beneficiary but he necessity be the legal owner. Where the assessee is the lessee of structure and he derives income from sub-letting or re-letting, it will not be taxable under this head of income but under the head 'Income from Other Sources' where the property is mortgaged, the mortgager is the owner and pays tax and not the mortgagee. One point which should be noted is that even if the owner is dealing in the business of letting out of house property, the income therefrom will be charged under Section 22 as income from house property and not under Section 28 under business and profession.

Deemed owner: Section 27 of the Act also gives for sure persons who are not the owners to be treated as deemed owners of house property. These persons have to pay the tax on income from such house property. They contain:

- An individual who transfers otherwise than for adequate consideration any house property to his or her spouse, not being a transfer in connection with an agreement to live-separately, or to a minor child not being-a married daughter, shall be deemed to be the owner of the house property so transferred.
- The holder an impartibly estate shall be deemed to be owner of the house property.
- A member of a cooperative society, to whom a structure or a part thereof is allotted or leased under the house structure scheme of the society, is treated as deemed owner of such property.
- A person who is allowed to take or retain possession of any structure or part thereof in part performance of a contract of the nature referred to in the transfer of property act.
- A person who acquires any rights in any structure or part thereof through virtue of any such transaction as is referred to in the clause (f) of section 268 va (transfer under purchase through central government of immovable properties)
- A person who takes land on lease and constructs a house upon it.

The House Property should not Used for Purposes of Assessee's Business or Profession

If the property or part thereof is used for assessee's business or profession, the income from which is chargeable to tax, then the annual value of such property or portion will not be taxed under Section 22 i.e. income from house property.

INCOME FROM HOUSE PROPERTY EXEMPT FROM TAX

There are two types of exemptions concerning income from house property: (1) which is totally exempt and (2) which is partially exempt. The first means which is neither incorporated in total income nor taxable and the second means which is incorporated in total income for rate purposes but is not taxed.

First Category: Income House Property which is Totally Exempt

- Buildings situated in the immediate vicinity of agricultural land and which is occupied through the cultivator as a dwelling house or as a store house. It is treated as agriculture income and is fully exempt.
- Any one palace in the job of a Ruler.
- House properties belonging to a local authority, scientific research association, University or other recognized educational institution, hospital, or Games or Sports Association and Registered Trade Union.
- Property belonging to an authority constituted under any law for the purpose of marketing of commodities and used for letting of godowns or warehouse for storage of commodities.
- House property held through a trust recognized wholly 'for charitable purposes.
- House property held through a political party.
- House property owned through an assessee and used for his own business or professional purposes.
- Self-occupied houses — The Finance Act, 1986 w.e.f. 1.4.1987 give that where the property consists of one house or part of a house in the job of the owner for his own residence and is not actually let out throughout any part of previous year, the annual value of such a house shall be taken to be nil.

Second Category: Income from House Property which is Partially Exempts

- Structure belonging to a co-operative society and income derived through it from letting of godowns or warehouses for storage of commodities.
- Structure belonging to a co-operative society, where the gross total income of the society does not exceed Rs. 20,000 and the society is not a housing society or an urban consumer’s society or a society carrying on transport business or a society occupied in manufacturing operations with the aid of power.

SOME SIGNIFICANT POINTS

- Income from house property situated abroad: Income from any house property situated abroad is taxable only in case of an individual. Not ordinary resident and non-resident pay tax on such property only when it is received in India. A resident will pay tax on foreign property as if such property is situated in India.
- Disputed Ownership: If the title of ownership is disputed in a court of law, the decision as to who is the owner rests with the income-tax department. Usually, the recipient of rental income or the person who is in possession of the property is treated as the owner.
- Composite Rent: If a structure is let out to a person along with other facilities (e.g. electricity, cooler, water pump, water tax etc.) for a composite rent and if the rent of the structure can be separated from the rent of such facilities, the two rents will be separated and that belonging to the structure only will be taxed under the head 'House Property' and that which belongs to other facilities will be taxed under the head 'Income from Other Sources'. If the composite rent cannot be split up it will not be taxed under the head 'House Property', but under the head ‘Other Sources.
- Property owned through Co-owners: Where a property is owned through two or more persons jointly and their respective shares are

definite and can be ascertained then income from such property shall not be assessed on such persons as association of persons, but the share of each person will be calculated and added to their respective total income.

- Income from sub-letting: This is chargeable under the head other sources as the person sub-letting is not the owner.

ANNUAL VALUE

As stated earlier, the assessee has to pay tax on the annual value of the house owned through him. So, it is very significant to calculate properly the annual value of the property. According to Section 23 of Income Tax Act, 1961, the annual value of a house property shall be:

- The sum for which the property might reasonably be expected to let from year to year; or
- Where the property is let and the actual rent received or receivable through the owner in respect thereof is in excess of the reasonable rent, the actual amount of rent received or receivable.

Any taxes levied through the local authorities and borne through the owner should be deducted to calculate the annual value of the property.

The definition creates it clear that annual value of the any house property is its reasonable rent. But, if the actual rent is higher than the reasonable rent then the actual rent received or receivable will be the annual value. It necessity be noted here that annual value is not determined through actual or reasonable rent alone. In case the rent of house property is fixed through rent controller under the Rent Control Act. The annual value in such a case cannot exceed the rent fixed through the Rent Controller, In case the actual rent exceeds the rent fixed through the rent controller then the actual rent would. be the annual value. It is clear that annual value is determined through taking into account several factors. They are:

- Municipal valuation fixed through the local authorities on the foundation of income earning capability of the property. It is fixed to calculate the house-tax to be paid through the owners.
- Actual rent received or receivable from the tenant.
- Reasonable rent i.e. the rent of similar properties in the similar locality, and
- Average rent the rent fixed through the Rent Controller under Rent Control Act. Where the Average Rent is applicable reasonable rent and municipal value will not be taken into consideration even though they are higher than the average rent.

COMPUTATION OF ANNUAL VALUE

When .a person owns a house he may inhabit it himself or rent it out. The annual value of house property would be dissimilar for the house which is given on rent and which is occupied through the owner for his residential purposes. For the purposes of calculation of annual value house property is divided into the following categories:

- House which is let out
- House which is occupied through the owners for residential purposes

Let Out House

The house which is let out is divided into two categories:

- Which is not sheltered through Rent 'control Act?
- Which is sheltered through Rent Control Act.

Which is not sheltered through Rent control Act

The actual rental income or the rent at which it might be expected to be let out or the municipal valuation, whichever is the highest, will be gross annual value. Any municipal taxes or tax levied through any local authority paid and borne through the owner shall be deducted from the gross annual value and the balance left will be the net annual value. The municipal taxes shall be deducted in the year in which they are actually paid, whether for current year only or for tile previous year and not on accrual foundation. Look at

Illustration, 1 and see how the annual value of let out house which is not sheltered through the Rent Control Act is calculated.

Which Is sheltered through the Rental Control Act

In this case average rent is fixed through the Rent Controller. The annual value will be the actual rent received or average rent, whichever is higher. It will be gross annual value. From the gross annual value any municipal taxes or tax levied through any local authority and paid and borne through the owner will be deducted and the balance left will be the net annual value. Look at Illustration.2 for calculation of annual value of a let out house sheltered under Rent Control Act:

Note: Even if the Municipal value or reasonable rent is higher than average rent or actual rent, they will not be measured in this case.

Statutory Deduction

New houses or units, whose construction commenced after 1st April, 1961, and which are let out for residential purposes are further entitled to statutory deduction from the annual value determined. This deduction is allowable for each self-governing unit of the house separately, as if each unit is a separate house. Each self-governing unit is that which has separate municipal number, separate electric and water meters and self-governing latrine; bathroom, kitchen etc. At present, the deduction is relevant for those houses which are completed after 31st March 1982. This deduction is allowed for an era of 60 months from the date of completion. The rate of deduction is as under:

- In respect of any residential unit whose annual value as determined does not exceed Rs. 3,600, the amount of such annual value and
- in respect of any residential unit whose annual value as determined exceeds Rs. 3,600, an amount of Rs. 3,600?

Self-occupied House

The owner of house can

- Inhabit the house for full year
- Inhabit the house for a part of the previous year and for some part of the previous year it is let out
- Inhabit a part of the house for full year and a part forthe part of the year (i.e. a part of the house is let out for apart of the previous year).

DEDUCTIONS FROM ANNUAL VALUE

For computing the income chargeable under the head 'Income from House Property', Section 24 gives for the following deductions to be made from the adjusted annual value of house property separately from the deductions concerning local taxes and statutory allowance. They are:

Repairs

- Where the property is let to a tenant or is deemed to be let out and the owner has undertaken to bear the cost of repairs a sum equal to 116th of adjusted annual value shall be deducted as Repairs Allowance. It is a statutory allowance which is always allowed irrespective of the information, whether the actual expenditure on repairs is less than or is more than 116th of annual value, or whether no amount is spent on repairs or even if the house remained vacant throughout the previous year.
- Where the property is in the job of a tenant who has undertaken to bear the cost of repairs, the repair allowance shall be limited to either:
    - ttt. The excess of annual value in excess of the amount of rent payable for a year through the tenant; or
    - uuu. A sum equal to 116th of the annual value, whichever is less.

Note: If adjusted annual value is less than or equal to actual rent payable throughout the year, no deduction is allowed in respect of repairs in that year.

REVIEW QUESTIONS

- Describe annual value and state the deductions that are allowed from the annual value in computing the income from house property.
- How would you determine the annual value of house property, which is self-occupied for a part of the year only and let out for the remaining part?
- Who are the 'deemed owners' of house property?
- What is composite rent?

CHAPTER 9

Capital Gains

STRUCTURE

- Learning objectives
- Meaning of capital gains
- Computation of capital gains
- Deductions allowed from extensive-term capital gains
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to :

- Explain the meaning of the term capital gains.
- List the capital gains exempt from tax.
- Talk about the deductions allowed from extensive-term capital gains.

MEANING OF CAPITAL GAINS

Any profits or gains arising from the transfer of a capital asset effected in the previous year shall be chargeable to income-tax under the head 'Capital Gains', and shall be deemed to be the income of the previous year in which the transfer took lay. The definition can be split up into three parts:

- Capital Asset
- Transfer of Capital Asset
- Profits or Gains

Concept of Capital Asset

Capital asset means property of any type held through an assessee whether or not linked with his business or. profession. The asset may be movable, immovable, tangible, or intangible. But the term capital asset does not contain:

- Any stock-in-trade, consumable stores or raw materials held for the purposes of his business or profession;
- Personal effects, that is to say, movable property (including wearing apparel and furniture but excluding jewellery) held for personal .use through the assessee or any member of his family dependent on him;
- Agricultural land in india (situated in rural areas) not being land situated within the limits of any municipality or a cantonment board having a population of 10,000 or more or situated in areas lying within a aloofness not exceeding 8 kilometers from the local limits of such municipalities or cantonment boards (i.e., agricultural land situated within municipal or cantonment board limits or within a aloofness of eight kilometers from the local limits of a municipality or cantonment board is incorporated in the term 'capital asset' and it is only the agricultural land which is situated outside such limits that is excluded from the term 'capital asset').
- 61/2% gold bonds, 1977 or 7% gold bonds, 1980 or national protection gold bonds, 1980, issued through the central government.
- Special bearer Bonds, 1991.

Types of Capital Assets

Interestingly the classification of capital asset does not depend on their durability but the era for which they have been held. Capital assets are divided into below categories:

- ***Short-term Capital Asset:*** Short-term Capital Asset means a capital asset held through an assessee for not more than 36 months immediately preceding the date of its transfer. In the case of a share held in a company, short-term capital asset will mean a share held through the assessee for not more than 12 months instead of 36 months in case of other assets.
- ***Extensive-term Capital Asset:*** Extensive-term Capital Asset means a capital asset (other than shares in a company) held through an assessee for more than 36 months immediately preceding the date of transfer. In

the case of shares held in a company, extensive-term capital asset will mean shares held through the assessee for more than 12 months.

- ***Short-term and Extensive-term Capital Gains:*** Capital gains arising from the transfer of short-term Capital Assets are described short-term Capital Gains: Capital gains arising from the transfer of extensive-term Capital Assets are described Extensive-term Capital Gains.

Concept of Transfer

Transfer in relation to a capital asset comprises (i) sale, swap, or relinquishment of the assets, or (ii) the extinguishment of any rights therein, or (iii) the compulsory acquisition through the Government under ally law, or (iv) where the asset is converted through the owner thereof into stock-in-trade of a business accepted on through him, such conversion. Further, where a business is converted into a limited company, there is a transfer of capital assets, or (v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in the Transfer of Property Act, 1882, or (vi) any transaction which has the effect of transferring or enabling the enjoyment of any immovable property.

Transactions not Regarded as Transfer

The following transactions are usually not regarded as transfer for the purpose of capital gains

- Any sharing of capital assets on the total or partial partition of a Hindu undivided family.
- Any transfer of a capital asset under a gift or will or an irrecoverable trust,.
- Any transfer of a capital asset through a company to its subsidiary company, if:

    vvv. The parent company holds the whole of the share capital of the subsidiary company, and www. The subsidiary company is an Indian Company.

- Any transfer of a capital asset through a subsidiary company to the holding company, if:
  xxx. The whole of the share capital of the subsidiary company is held through the holding company, and
  yyy. The holding company is an Indian Company. Any transfer of a capital asset as per clause (iii) or (iv) above shall be treated as transfer if the transfer is made after 29th February, 1968, as Stock-in-trade.
- Any transfer, in a scheme of amalgamation, of a capital asset through the amalgamating company to the amalgamated company if the amalgamated company is an Indian Company.
- Any transfer through a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held through him in the amalgamating company, if:
  zzz. The transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
  aaaa. The amalgamated company is an Indian Company.
- Any transfer of agricultural land in India effected before 1st March, 1970.
- Any transfer of a capital asset, being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, photograph or print, to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified through the central Government in Official Gazette to be of national importance or to be bf renown throughout any State or States.

COMPUTATION OF CAPITAL GAINS

The income chargeable under the head 'Capital Gains' shall be computed through deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts:

- Expenditure incurred wholly and exclusively in connection with such transfer, and
- The cost of Acquisition of the capital asset and cost of any improvement there of.

This may be explained in the form of equation as under:

$$\text{Capital Gain} = \text{Full value of consideration} - (\text{Cost of acquisition} + \text{Cost of improvement} + \text{Selling Expenses})$$

CAPITAL GAINS EXEMT FROM TAX

As discussed earlier any profits or gains arising from transfer of any capital asset are chargeable under the head capital gains. But ally profits or gains arising out of transfer of sure Capital assets are exempt from tax i.e., such profits or gains are not incorporated in the taxable income of the assessee. The capital gains exempt from tax are :

- Capital gains arising from the transfer of a residential house subject to the circumstances laid down u/s 53.
- Capital gains arising on the transfer of property used for residence and the land appurtenant thereto subject to the circumstances laid down u/s 54.
- Capital gains arising from the transfer of agricultural land situated in an urban area are exempt subject to the provisions contained in Section 54B.
- Any capital gains arising out of compulsory acquisition of land and buildings are exempt from tax subject to the provisions of Section 54D.
- Subject to the circumstances of Section 54E, the capital gains arising on transfer of an extensive-term capital asset are exempt from tax.
- Any extensive-term capital gains arising on investment in residential houses is exempt subject to circumstances laid down in Section 54F.

- Capital gains on shifting of industrial undertaking from urban area are exempt from tax subject to the circumstances laid down in Section 54G.

Note : For the purposes of exemption u/s 53, 54, 54B, 54D,54E, 54F, and 54G capital gain shall be computed as under:

Full value of consideration-(Cost of acquisition + Cost of improvement + expenditure incurred in connection with transfer)

Capital Gains arising from the transfer of a residential house (Sec. 53) Under this section if the following circumstances are satisfied the capital gain 'shall be exempt from tax:

- The structure is owned through an Individual or Hindu Undivided Family
- The structure is used for residential purposes (self-occupied or let out) and its income is chargeable under the head Income from House Property.
- The structure has been held through the assessee for more than 36 months before its transfer.
- The assessee does not own any other residential house on the date of such transfer.
- If the consideration received or accruing as a result of the transfer does not exceed Rs. 2 lakhs, the whole amount of capital gain is exempt. If such consideration exceeds Rs. 2 lakhs, the capital gain would be exempted proportionately. In other words, the amount of capital gain to be exempted would bear the similar proportion to the amount of the capital gain arising from the transfer as the amount of Rs. 2 lakhs bears to the amount of consideration received or accruing from the transfer.

Capital gains arising on the transfer of property used for residence (Sec. 54) : Any capital gain arising from the transfer of a house or land appurtenant thereto is exempt subject to the, following circumstances:

- The structure is owned through an individual or H.U.F.
- Such property was being used as residential house.
- The income of such property is chargeable under the head income from house property.
- The exemption will be accessible only in relation to a house property which had been held through the tax-payer for a era exceeding 36 months before transfer.
- The assessee has, within a era of one year before or two years' after the date of transfer purchased a residential house he has within a era of three years after the date of transfer constructed a residential house.
- The capital gains arising from the transfer of such residential house is exempt to the extent of the cost of the new residential house purchased or constructed within the specified era. It means that if, the whole capital gain is re-invested in the cost of the new house it is fully exempt from tax. If only a part of it is re-invested, the balance of it is chargeable to tax.
- Where the amount of capital gain is not utilized through the assessee for acquisition of new house before the date of furnishing the return of income, it shall be deposited through him on or before the due date of furnishing the return of income u/s 139, in an account opened under the Capital Gains Accounts Scheme, 1988, with State Bank of India or any of its subsidiaries or with any nationalized bank authorized through the Central Government. The amount already utilized for re-investment jointly with the amount of deposits shall be deemed to be the cost of the new house. After such deposit him necessity utilizes the deposit for acquiring the new house within 3 years.

Capital gain arising from the transfer of agricultural land (S. 54B) : Any capital gain arising on the transfer of agricultural land situated in an urban area is exempt subject to the following circumstances :

- The agricultural land is owned through an individual.

- The agricultural land was, in the two years immediately preceding the date of transfer, being used either through the assessee or his parent for agricultural purposes.
- The assessee has purchased within a era of two years, from the date of transfer, any other land for being used for agricultural purposes.
- The capital gain arising from the transfer of such agricultural land is exempt to the extent of the cost of the new agricultural land purchased within the specified era mentioned in (c) above. It means that if the whole capital gain is re-invested it is fully exempt from tax. If only a part of it is re-invested the balance of it is chargeable to tax.
- if the amount of capital gain is not utilized through the assessee for acquisition of new agricultural land before the due date for furnishing the return of income, it shall be deposited through him on or before the due date of furnishing the return of income in an account opened under the Capital Gains Account Scheme, 1988. The amount already utilized for re-investment jointly with the amount of deposits shall be deemed to be the cost of the new agricultural land. If the amount deposited is not fully utilized for acquiring the new agricultural land within two years, the amount not so utilized shall be treated as the extensive-term capital gain of the previous year in which the era of two years expires.

Capital Gain on the transfer of extensive-term Capital Asset (Sec. 54E) : Any capital gain on the transfer of a extensive-term capital asset is exempt if the following 'circumstances are satisfied:

- The assessee has transferred a extensive-term capital asset.
- The net consideration (i.e. net sale proceeds) has been invested in specified new asset through initially subscribing to such new asset within six months from the date of transfer of the asset.
- If a part of net consideration is invested, proportionate part of the capital gain will be exempt from tax.
- If the assessee receives some money as earnest money or advance and invests in the specified assets before the date of transfer of asset, the amount so invested will qualify for exemption under section 54E.

- Where the asset is transferred after 31.3.1989 the exemption will be accessible if the amount is invested in—

  bbbb. Securities of the Central Government specified through that government in this behalf;

  cccc. Special series of units of the Unit Trust of India specified through the Central Government in this behalf. Units issued under the Capital Gains Unit Scheme, 1983 have been notified for this purpose.

  dddd. Notified National Rural Development Bonds.

  eeee. Such debentures issued through the Housing and Urban Development Finance Corporation Limited, as the Central Government may specify in this behalf,

  ffff. Notified Bonds issued through any public sector company.

  gggg. Notified debentures or bonds issued through the National Housing Bank.

The assessee will be required to hold the new asset for a era of three years from the date of its acquisition. The exemption will be forfeited if the assessee transfers the assets with three years and the exempted, capital gain will be taxed as long-term capital gain in the year in which the assets are transferred.

DEDUCTIONS ALLOWED FROM EXTENSIVE-TERM CAPITAL GAINS

You know how the amount of capital gains is calculated. After this amount has been computed as explained in Section 9.3 sure deductions are to be made in order to calculate the taxable amount of capital gains. Before explaining the deductions we necessity reminded you that gains are of two kinds short-term and extensive-term capital gains.

No deduction is allowed from short-term capital gains i.e., the total amount, of short-term capital gains is taxable. As distant as the extensive-term capital gains are concerned sure deductions are allowed u/s 48(2). The amount of deduction is calculated as follows:

- Where the amount of extensive-term capital gain, does not exceed Rs. 10,000 the whole of such amount shall be deducted, or
- Where the amount of extensive-term capital gain exceeds Rs. 10,000 the following deductions shall be made.

REVIEW QUESTIONS

- What does the term 'Capital Gains' signify under the Income Tax Act?
- Talk about the provisions of the Income-tax Act concerning exemption of capital gains U/S 54E?

CHAPTER 10

Income from other Sources

STRUCTURE

- Learning objectives
- Income chargeable under the head 'income from other sources'
- Deductions allowed
- Dividends
- Winnings from lotteries, crossword puzzles, horse races, card games, etc.
- Interest on securities
- Set-off and carry forward of losses
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- List the incomes falling under the head 'Income from other sources';
- Explain in detail the provisions of income tax for dividends and interest on securities;
- Talk about the set off and carry forward of losses

INCOME CHARGEABLE UNDER THE HEAD 'INCOME FROM OTHER SOURCES'

Section 56(1) of the act states that, every type of income which is incorporated in the total income under the Income-tax Act, and which is not chargeable to income tax under any other head of income, is chargeable to income tax under the head from Other Sources'.

Under Section 56(2), the following incomes shall be chargeable under the head 'Other Sources':

- Dividends;

- Income from winnings from lotteries, crossword puzzles, races including horse races, card games or any other games, gambling or betting etc.
- Any sum received through the assessee from his employees as contribution to any provident finance or superannuation finance or any finance set up under Employees' Insurance Act 1948 or any other finance for the welfare of the employees provided it is not chargeable under the head "Profits and Gains of Business or Profession".
- Income through method of interest on Securities if not chargeable under "Profits and Gains of Business or Profession".
- Income from machinery, plant or furniture belonging to the assessee and let on hire if the income is not chargeable to income tax under the head 'Business or Profession'.
- Where an assessee lets on hire machinery, plant or furniture belonging to him and also buildings, and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if not chargeable to income tax under the head 'business' is chargeable under the head 'Other Sources'.

There are some other incomes also which are chargeable under the head 'Income from Other Sources'. They are:

- Any fees or commission received through an employee from a person other than his employer.
- Any annuity received under a will. It does not contain an annuity received through an employee from his employer.
- All interest other than interest on securities.
- Income of a tenant from sub-letting the whole or a part of the house property.
- Remuneration received through a non-professional for doing examination work, viz., and a professor getting such remuneration.
- Income of Royalty.
- Director's fees.
- Rent of land not appurtenant to any structure.

- Agricultural Income from land situated outside India.
- Income from markets, ferries and fisheries, etc.
- Income from leasehold property.
- Income of other persons incorporated in the total income of the assessee, e.g., if the assessee and his spouse are partners in the similar firm, the share of income' of the spouse is incorporated in the total income of the assessee under the head 'Income from Other Sources'.
- Income received through non-professionals in consideration of writing articles in Journals.
- Interest received on foreign securities.
- Income from undisclosed sources.
- Interest received through an employee on his own contributions to an unrecognized provident finance.
- Casual income in excess of Rs. 5,000.
- Salary of Member of Parliament, Member of Legislative Assembly or Council.
- Interest received on securities of a co-operative society.
- Family pension received through the widow and heirs of deceased employees.
- Income received from units of Unit Trust of India.
- Amount withdrawn from deposit in National Savings Scheme on which deduction u/s 80CCA has been allowed including interest thereon.

DEDUCTIONS ALLOWED

Under Section 57, the income chargeable under the head 'Income from Other Sources' shall be computed after creation the following deductions :

- In the case of dividends or interest on securities, any reasonable sum paid through method of commission or remuneration to a banker or any other person for the purpose of realizing such dividend or interest on behalf of the assessee, is deductible. No such deduction is allowed in case of a foreign company.

- Where employees' contribution to Provident Finance, etc., are treated as the income of the assessee (employer) it is incorporated in his income from other sources and a deduction of the sum, credited through the assessee to the employee's account in the relevant finance on or before the due date, will be allowed under this head.
- In the case of income from letting of machinery, plant or furniture along with letting of buildings, which is chargeable to tax under the head 'income from other sources', the deductions in respect of the following shall be allowed:
  - hhhh. Expenditure incurred concerning current repairs of machinery, plant, furniture, or structure.
  - iiii. Insurance premium paid concerning structure, machinery, plant, or furniture against risk of damage or destruction of the assets.
  - jjjj. Depreciation on buildings, machinery, plant, or furniture.
- In the case of income in the nature of family pension received through the widows or heirs of deceased employee, a deduction of sum equal to 33 1/3% of such income or Rs. 12,000, whichever is less, will be allowed.
- Any other revenue expenditure incurred wholly and exclusively for the purpose of earning such income. It should not be in the nature of personal expenses of the assessee. No such deduction is allowed in case of a foreign company.

DIVIDENDS

In ordinary language dividend means the sum received through a shareholder of a company on the sharing of its profits; but under Section 2(22) dividend comprises the following:

- Any sharing through a company of accumulated profits if such sharing entails the release through the company to its shareholders of all or any of the assets of the company.

- Any sharing to its shareholders through a company of debentures or deposit certificates in any form, and any sharing to its preference shareholders of shares through method of bonus, to the extent to which the company possesses accumulated profits.
- Any sharing made to the shareholders of a company on its liquidation, to the extent to which the sharing is attributable to the accumulated profits of the company immediately before its liquidation.
- Any sharing to its shareholders through a company on the reduction of its capital, to the extent to which the company possesses accumulated profits.
- Any payment through a company, not being a company, in which the public are considerably in (crested, of any sum through method of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power or to any concern in which such shareholder is a member or a partner and in which, he has a substantial interest, to the extent to which the company possesses accumulated profits except where the advance or loan is made to a shareholder or the said concern through a company in the ordinary course of its business, where the lending of money is substantial part of the business of the company.

Dividend does not Contain the Following

- A sharing made in accordance with the above Clause (c) or Clause (d) in respect of any shares issued for full cash consideration, where the holder of shares is not entitled in the event of liquidation to participate in the surplus assets.
- A sharing made in accordance with Clause (c) or Clause (d) in so distant as such sharing is attributable to the capitalized profits of the company on behalf of bonus shares allotted to its equity shareholders after March 31,1964 and before April 1, 1965.

- Where the company goes into liquidation consequent of the compulsory acquisition of its undertaking through the Government or any Corporation owned or controlled through Government the sharing made through the liquidator of the company to its shareholders will not be charged to tax as 'dividend' to the extent such sharing is attributable to the accumulated profits of the company relating to any era prior to the three successive previous years immediately proceeding the previous year in which the undertaking of the company is acquired.
- Any advance or loan made to a shareholder of the said concern through the company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company.
- Any dividend paid through a company which is set-off through the company against the whole or any part of the sum previously paid through it as advance or loan referred to above in Clause (e).
- Where a company transfers its assets to another company in a scheme of amalgamation, such transfer is not regarded as a 'sharing' through the company of its accumulated profits to its shareholders even though its accumulated profits are embedded in the assets so transferred.

Rules for Taxation of Dividends

The following are the rules for taxations of dividends:

- Any dividends declared through a company shall he deemed to be the income of the shareholders of the previous year in which it is declared.
- Any interim dividend shall be deemed to be the income of the shareholders of the previous year in which the amount of such dividend is unconditionally made accessible through the company to the members who are entitled to it, It means that the date of declaration of such dividends is immaterial so extensive as the amount is not released for disbursement.
- Dividend paid through an Indian Company outside India shall be deemed to accrue or arise in India.

- The whole amount of dividend received through a shareholder is taxable in his hands, even if the company had distributed this dividend out of non-taxable income, e.g., 60% of the income of a tea company is treated as agricultural income which is not taxable but the whole amount of dividend received through the shareholder of this company will be taxable in his hands with few exceptions.
- In the case of dividend received from a foreign company if the foreign company has deducted tax at source and nothing is paid out of it to the Government of India, the amount deducted as tax at source shall not be incorporated in the dividend income of the Indian shareholder.
- The income tax deducted at source from the dividend declared for the shareholders is to be incorporated in the dividend income of the shareholders and as such the net amount of dividend received through a shareholder has to be grossed up or increased through the amount of tax deducted at source, and the shareholder gets credit in his assessment for the amount of tax deducted at source from the dividends declared through the company.

Grossing up of Dividends

Dividends may be tax-free or less tax. Tax-free dividends are those dividends for which the company does not deduct income tax at source. The total amount of dividend declared is paid to the shareholders. The income tax though not deducted is paid through the company to the income tax department on behalf of the shareholders such income tax is actually the income of the shareholder so while calculating of income from dividends the tax-free dividends are to be grossed up.

Likewise less tax dividends are to be grossed up because in this case the income tax is deducted at source through the company and the net amount is paid to the shareholder. But the income from dividends earned through the shareholder is not the net dividend but the gross dividend before income tax is deducted therefrom, for the year 1989-90 the rate of deduction of tax at source for less tax dividends is 21.6%. In order to gross up less tax dividends, the net amount of dividend received should be multiplied through 100/78.4. Though, dividends shall be paid without deduction of tax at source in the following cases if—

- It is paid to the non-company resident shareholders, who furnishes to the company (which pays dividend) a certificate from Assessing Officer that to the best of his belief the total income of the shareholder will be less than the minimum exempted limit of income-tax.
- It is paid through a widely-held company to an individual who is resident in India if

  kkkk. The dividend is paid through an account payee cheque; and

  llll. The amount of such dividend throughout the financial year does not exceed Rs. 2,5001-.

WINNINGS FROM LOTTERIES, CROSSWORD PUZZLES, HORSE RACES, CARD GAMES, ETC.

Income from winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form of nature whatsoever, is taxable under head 'Income from Other Sources'. No deduction in respect of expenditure or allowance in connection with income through method of winnings from lotteries, cross word puzzles, horse races, card games etc. shall be allowed in computing the said income.

Though, the person responsible for paying to any person any income through method of winnings from any lottery or crossword puzzles or horse race, of an amount exceeding Rs. 5,000 shall at the time of payment deduct income tax thereon at 43.2% throughout the financial year 1990-91 for the assessment year 1991-92. It was the similar rate throughout the financial year 1989-90 for the assessment year 1990-91 in the case of resident non-corporate tax-payers. The amount of tax deducted at source shall be credited in the account of the assessee in his individual assessment,

INTEREST ON SECURITIES

Interest on Securities if charged under the head ‘income from other sources' mear the following:

- Interest on any security of the Central or State Government;
- Interest on debentures or other securities for money issued through or on behalf of a local authority;
- Interest on debentures issued' through a company (whether Indian or foreign); and
- Interest on debentures or other securities issued through a Statutory Corporation.

Security means an acknowledgement of a debt represented through a debenture, bond, etc., issued through the Central or any State Government, local authority, statutory corporation, or a company. Even securities issued through a foreign government or foreign company are sheltered through this definition of securities and interest thereon will be chargeable as interest on securities.

Foundation of Charge

- Income from interest on securities is chargeable on due foundation if the assessee follows mercantile system of accounting. In case books are maintained on cash foundation this income is taxable on receipt foundation. Though, where no method of accounting is regularly employed through the assessee, the income from interest on securities shall be chargeable to tax as the income of the previous year in which it becomes due though it may be received latter.
- Interest on securities does not accrue from day to day but becomes due on sure fixed dates only; which are mentioned on the security itself. It means that interest on securities is chargeable to tax in the hands of one who holds the securities, as owner, on the due date of interest.

Where securities are sold before the due date of interest, the whole amount of interest payable on the after that due date shall be deemed to be the income of the buyer who holds the securities on the said due date as owner thereof. This amount will not be apportioned on time foundation flanked by the seller and the buyer, whether it is bought and sold on cum—int. foundation or ex. int. foundation.

- Interest on securities shall be chargeable to tax under the 'Business or Profession' if securities are held as stock-in-trade or under the head 'Income from Other Sources', if securities are held as investments.

Types of Securities

Securities may be (1) Government Securities and (2) Commercial Securities. Government Securities may further be sub-divided into (i) Less Tax Securities and (ii) Tax-free Securities. Likewise Commercial Securities may also be sub-divided into (i) Less Tax Securities and (ii) Tax-free Securities.

Government Securities

- ***Less Tax Government Securities :*** In the case of these securities, income tax is deducted at source on the account of interest calculated at the percentage stated on the securities and the balance of the amount of interest left after deduction of the aforesaid income tax is paid to the security-holder. In this case the gross amount of interest (calculated at the rate per cent given on the security) is liable to tax in the hands of the owner of the securities, end the tax deducted at source will be deducted from the total tax payable through the assessee.
- ***Tax-free Government Securities :*** Securities, the interest on which is exempt from tax and also excluded from computation of total income in case of all assesses are described tax-free government securities. These are fully exempted securities. There are no partially exempted government securities. Government specifically declares sure

securities to be tax-free. Though, there are some persons who are exempt from tax concerning their income from interest from government securities (even if they are, otherwise, taxable); but it does not mean that these are tax-free securities. It is only the holder who is exempt.

Commercial Securities

- ***Less Tar Commercial Securities:*** These are presently like the less tax government securities. The only variation is that these are 'issued through some company or corporation and the government securities are issued through the government. From tax point of view there is no variation flanked by the two.

- ***<u>Tax free Commercial Securities :</u>*** These are issued through a company or some other business-institution. Really speaking, their interest is not tax-free, because tax due on this interest is' payable through the company or the business institution concerned. These are described tax-free because the whole amount of interest due is paid to the assessee without deduction of tax at source and the assessee has not to pay tax on it from his own pocket. The tax paid through the company on this interest is deemed to have been paid on behalf of the assessee, hence the relevant amount of tax paid on any interest due to an assessee is added up in his interest income, i.e., the interest due to an assessee is grossed up and then this grossed up amount is incorporated in his total income. No relief is granted on this interest, except that the, amount of tax paid through the company on this interest is deducted from the total tax payable through the assessee on his total income, and the balance of amount left is payable through the assessee as tax. For instance, if a company has issued 10% tax-free Debentures, the debenture-holder will receive the whole amount of interest calculated at 10% but the amount to be incorporated in the total income of the debenture-holder will be the amount actually received through him as interest plus income tax thereon paid through the company. The net amount of income tax payable through the debenture holder will be the total tax payable through him on his total income minus the tax paid through the company on his behalf on interest on debentures.

Grossing up of Interest on Securities

The following are the rules for grossing up interest on securities:

- If the rate of interest is given, only the interest of tax-free commercial securities is grossed up and interest on all other securities is not grossed up.
- Interest on tax-free commercial securities is always grossed up whether its rate per cent is given or the amount received is given.

- Interest on less tax securities is grossed up only when the amount received is given.

Bond washing Transactions

These transactions are not genuine. It is a device to avoid tax. Usually, interest on securities is payable half-yearly or yearly on fixed dates. As the whole amount of interest is regarded as the income of the person who happens to be the owner on the due date of interest, some tactful persons sell their securities a few days before the due date of interest, to some of their friends or relatives and buy it back a few days after the due date. Therefore they do not remain the owner of the securities on the due date and they are not required to pay tax on this income from interest on securities.

They sell their securities to such persons whose total income including the income from interest on securities either does not exceed the minimum taxable limit or if it exceeds that limit it is lesser than that of the seller, so that either no tax will be payable on such interest or it will be payable at a lower rate. Therefore the seller escapes tax totally; and the buyer also does not pay tax on it as his income is below the minimum taxable limit; and even if the buyer's income exceeds the minimum taxable limit, he will pay tax at lower rate, which is in information, secretly paid through the seller on behalf of the buyer. Such transactions are described 'Bond washing Transactions'. The common rule that tax is payable through the person who is the owner of the securities on the due date of interest does not apply to bond washing transactions. In order to prevent this device of avoiding tax, it has been provided that the Assessing Officer can contain the whole interest in respect of bond washing transactions in the income of the transferor and not in the income of the transferee.

Interest on Securities Exempt from Tax

According to Section 10(15) the interest on sure securities is fully exempt from tax. They are:

- Income through method of interest, premium on redemption or other payment on such securities, bonds, annuity certificates, savings certificates, and other certificates issued through the Central Government and notified in this behalf to the extent of as notified.

Under clause (i) the interest/premium on the following securities/bonds shall be fully exempt:

- 12 years National Savings Annuity Certificates.
- National Defense Gold Bonds, 1980.
- Special Bearer Bonds, 1991.
- Treasury Savings Deposit Certificates (10 years).
- Post Office Cash Certificates (5 years).
- National Plan Certificates (10 years).
- National Plan Savings Certificates (12 years).
- Post Office National Savings Certificates (7 years/12 years).
- Post Office Savings Bank Account.
- Post Office Cumulative Time Deposit Rules, 1981.
- Scheme of Fixed Deposits governed through the Government Savings Certificates
- (Fixed Deposits) Rules, 1968.
- Scheme of Fixed Deposits governed through the Post Office (Fixed Deposits)
- Rules, 1968.
- Special Deposit Scheme, 1981.

Further interest on Public Account shall be exempt upto Rs. 5,000.

Under the Post Office Savings Bank Rules a 'Public Account' can be opened through a local authority, a lawfully constituted association, institution or other body for the encouragement of thrift or for the mutual benefit of its members and a High School and Intermediate College (Payment of Salaries of Teachers and other Employees) Act, 1971.

- 7% Capital Investment Bonds held through individual and H.U.F. assesses only.
- In the case of an individual of Hindu undivided family, interest on 9% Relief Bonds shall be exempt.
- Interest on the notified bonds arising to following is exempt subject to sure circumstances:

    mmmm. A non-resident Indian, being an individual owning the bonds; or nnnn. Any individual owning the bonds through virtue of being a nominee or survivor of such non-resident Indian; or

oooo. Through an individual to whom the bonds have been gifted through Non-resident Indian.

SET-OFF AND CARRY FORWARD OF LOSSES

Set-off of losses means setting-off losses against the income of the similar year. Where it is not possible to set-off the losses throughout the similar assessment year in which they occurred so much of the loss as has not been so set-off out of sure specified losses can be accepted forward for being set-off against his income in the succeeding years provided the losses have been determined in pursuance of a return filed through the assessee within the time allowed uls 139(1) or within such further time as may be allowed through the Assessing Officer and it is the similar assessee who sustained the loss and the business is continuing.

Inter-Source Adjustment

Where there is more than one source of income under the similar head, the loss from one or more sources is allowed to be set-off against the income from the other sources. It meaqs that where the net result for any assessment year in respect of any source falling under any head of income is a loss, the assessee shall be entitled to have the amount of such loss set-off against the income from any other source under the similar head. This is described inter-source adjustment. For instance, suppose an assessee has four house properties. Three of them yield net taxable income; but from the fourth there is net loss. The assessee can set off the loss of one house property against the income of the remaining house properties. Likewise, if an assessee has four businesses of dissimilar nature, In a scrupulous year suppose from two businesses there is taxable profit and from the remaining two businesses there is loss. The loss of these two businesses can be set off against the profits of the other two businesses.

Exceptions:

- Speculation losses can be set off only against profits, if any, of another speculation businesses accepted on through the assessee. They cannot be set-off either against any other regular business or against any other head of income.
- Losses from the activity of owning and maintaining race horses in any assessment year shall be set-off only against income from owning and maintaining race-horses only and not against any other income.
- Losses from other businesses will not be allowed to be set-off against winnings from races, lotteries, etc.

Inter-Head Adjustment

Where in respect of any assessment year the net result of the computation under any head of income is a loss, the assessee shall be entitled to have the amount of such loss set-off against his income, if any, assessable under any other head of income. There are, though, sure exceptions to this common rule, which are as under:

Exception : Loss under the head 'Income from House Property' on account of unrealized rent. Such loss cannot be set-off against income under any other head.

Therefore , the loss from 'non-speculative business' or 'capital losses (whether short-term or extensive-term) may be set-off against the income falling under any other head 'Salaries', 'Income from House Property', 'Capital Gain', 'Income from other sources' (excluding winning from races, lotteries etc.).

Set-Off of Capital Losses

Such losses can be set-off against the gain from any other short-term capital assets or extensive-term capital assets as well as against the income under any other head of income. Extensive-term capital losses will be scaled down in the similar manner and through the similar percentage of deduction, as are allowed out of extensive-term capital gains and thereafter, the balance of extensive-term capital losses shall be set-off against income under any other head in the similar year as business losses.

Carry Forward and Set-Off of Capital Losses

Capital Losses (Whether short-term or extensive-term)

Capital losses which cannot be wholly or partially set-off in the similar assessment year, against income under any other head, shall be accepted forward to the following assessment year and shall be set-off against income, if any, under the head capital gains. If the whole amount of accepted forward capital loss cannot be set-off in the following assessment year, the amount remaining unabsorbed shall be accepted forward to be set-off against capital gains in subsequent years upto a maximum of eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Special provisions concerning extensive-term capital losses of assessment years prior to the assessment year '1988-89 accepted forward to the assessment year 1988-89 or any subsequent year:

- Accepted forward extensive-term capital losses of any assessment year prior to the assessment year 1988-89 shall be dealt with in the assessment year 1988-89 or any subsequent assessment year in the following manner:

It shall be reduced through the deductions specified in Section 48(3) (i.e., first Rs. 10,000 plus 10% or 30% of the balance in the case of a company, and 50% or 60% in the case of any other assessee depending on the category of the asset concerned) and the reduced amount shall be accepted forward and set-off against income under the head 'capital gains'; but such carry forward shall not be allowed beyond the fourth assessment year immediately succeeding the assessment year for which the loss was first computed.

REVIEW QUESTIONS

- Explain clearly the meaning of the term 'dividend' as defined in the Indian Income-Tax Act, and point out the law relating to taxation of dividends.
- Talk about the several types of securities? Explain the rule concerning grossing up of interest on Tax-Free Commercial Securities.
- Explain Bond Washing Transactions? How it is a device to avoid tax?

PART 4. ASSESSMENT OF INDIVIDUAL

CHAPTER 11

Deductions from Gross Total Income

STRUCTURE

- Learning objectives
- Deductions from gross total income
- Deductions to encourage savings
- Deductions for sure personal expenditure
- Deductions for encouraging voluntary participation in charitable and socially desirable behaviors
- Deductions for economic growth
- Deductions in respect of earnings in foreign swap
- Deductions in the case of totally blind or physically handicapped resident persons (section 80-u)
- Review questions

LEARNING OBJECTIVES

After learning this chapter you should be able to :

- List the deductions accessible from gross total income.
- Calculate the amount of each deduction.
- Compute the taxable income of an assessee after allowing such deductions.

DEDUCTIONS FROM GROSS TOTAL INCOME

The first step in the computation of income is to work out the income under the individual heads of income. Computation under each head takes into account the expenditure incidental to earning such income. The aggregate of income under each head is recognized as "Gross Total Income". Sure deductions which are not necessarily referable to any scrupulous head are allowed out of Gross Total Income to arrive at the Total Income liable to tax.

DEDUCTIONS TO ENCOURAGE SAVINGS

These deductions are allowed if the tax-payer creates savings and invests it in specified areas. Some of these are based on gross amount of savings, which means that benefit allowed is not withdrawn when the saved amount is disinvested after the specified era. There are others which provide tax benefit only on net savings. Deduction is allowed when the saving is deposited/invested but any withdrawal/disinvestment is treated as income in the year of withdrawal. Therefore only the net saving gets tax benefit. Deduction is also allowed in respect of income from sure investments.

Based on Gross Amount of Savings

In respect of Life Insurance Premium etc. (Sec. 80-C)

This section gives for deduction in respect of the under mentioned payments and contributions :

- Payments in respect of life insurance premia;
- Payments made to effect or stay in force a contract for deferred annuity;
- Contribution to a Recognized Provident 'Finance;
- Subscriptions to the Public Provident Finance Scheme;
- Deposits under Post Office Savings Bank (Cumulative Time Deposits) Rules 1959;
- Contributions to an Approved Superannuation Finance;
- Contributions for participating in the Unit-connected Insurance Plan;
- Subscriptions to National Saving Certificate;
- Deposits with the National Housing Bank;
- Payments in respect of purchase or construction of a residential house.

The deduction, though, is admissible subject to the limits of the amount qualifying for the similar and sure circumstances laid down tin the sections, In case of authors, playwrights, artists, musicians, actors or sportsmen including athletes, the limit of amount qualifying for the deduction is Rs. Rs. 60,000 or sums actually paid, whichever is least.

In case of other individuals and Hindu Undivided, families this limit is Rs. 40,000.

Quantum of Deduction

The quantum of deduction in respect of the qualifying amount is :

- At 100% on the first 6,000
- At 50% on the after that 6,000 and
- At 40% on the balance of the qualifying amount.

Switch in Excess of to System of Granting Tax Rebate

The system of granting deduction, on a slab foundation is applicable upto the assessment year 1990-91. For Assessment year 1991-92 and onwards there is a switch in excess of to a system of granting tax rebates. Therefore under the new provisions the tax liability of the assessee will be computed and a tax rebate of 20 per cent of the qualifying savings would be allowed. The maximum tax rebate admissible is Rs. 10,000 usually. Though, in case of authors, playwrights, artists, Musician, actors, or sportsmen the limit is Rs. 14,000.

Circumstances for Deduction

As stated earlier these deductions are accessible subject to sure circumstances. These are discussed below :

- ***For Life Insurance Premium:*** Payments made on account of Life Insurance Premium would be eligible for deduction/rebate if:

    pppp. The insurance premium is paid in order to effect or stay in force an insurance on the life of the assessee, his/her spouse or child.

qqqq. The premium paid in excess to 10% of the capital sum assured does not qualify for deduction.

rrrr. Where the tax payer terminates a policy of life insurance before paying premium for 2 years, no deduction will be allowed in respect of premium paid in the year in which the policy is terminated. Further the amount of deduction allowed in respect of premium paid in the preceding year will be deemed to be income of the year in which the policy is terminable.

- ***Payments for deferred annuities:*** Any sum paid in order to effect or stay in force, a contract for deferred annuity provided such contract does not contain a provision for an option to be the insured to receive a cash payment in lieu of the payment of annuity.

ssss. In case of an individual on his own life or the life of his spouse or child, It is significant to note that the restriction in respect of sums paid in excess of 10% of capital sum assured does not apply to deferred annuity policies.

- ***Contribution to recognized provided finance:*** Where the assessee is an employee participating in a recognized provided finance, his own contribution to the finance shall be deductible upto one-fifth of his salary. 'Salary' for this purpose comprises dearness allowance if the conditions of employment so give but it does not contain" any other allowance or 'Perquisites'.
- ***Subscription to the Public Provident Finance Scheme:*** This scheme was introduced through the Government for the benefit of self-employed persons such as doctors, lawyer's ktc. in scrupulous. Under it an individual may subscribe to the finance on his own behalf and also on behalf of a minor ward.

The salient characteristics of the scheme are —

- An account can be opened at any branch of State Bank of India and its subordinate or at any head Post Office or at some related branches of other nationalized banks.

- Subscription may be of any amount not less than Rs. 100 and not more than Rs. 60,000 in every financial year.
- Loans from the funds are permitted in or after the third year of opening the account; of an amount up to 25% of the balance to the credit of the assessee at the end of the 2nd preceding financial year. Interest is charged at 13% and the loan is repayable in 24 months.
- Withdrawals are also permitted 'every year flanked by the 6th arid 15th year of an amount not exceeding 50% of the balance to the credit of the assessee at the end of the 4th year immediately preceding the year of withdrawal or at the end of the preceding year whichever is lower.
- A person can continue his account after 15 years with or without fresh subscription for a block era of 5 years.
- Deposits in 10 years or 15 years account under the Post Office Savings Bank (Cumulative Time Deposits) Rules 1959: The minimum deposit under this scheme is Rs. 10 with multiples of Rs. 5 and the maximum limit is Rs. 1,000 per month. A loan up to 50% of the balance is permitted twice in a era of 10 years. An individual can create deposit in more than one account e.g. in the name of the wife, children, etc.
- Contribution to an approved superannuation finance through an employee qualifies for deduction.
- Contribution for participating in the Unit connected insurance plan: Any sum paid through an individual as contribution for participation in the Unit Connected Insurance Plan, 1971 of the Unit Trust of India qualifies for deduction. It is significant to note, though, that if a member terminates his participation before creation contribution for a era of 5 years, no deduction will be allowed in respect of contribution made in such year. Besides, an aggregate of deduction allowed in respect of contribution to the plan in past years will be incorporated in the total income of the previous year in which he terminates his participation in the plan.
- Subscription to National Savings Certificates: This deduction is accessible to individuals and H.U. Funds subscriptions to NSCs VIII issues carry an interest of 12% per annum.

- Deposits with National Housing Bank with effect from the A.Y. 1990-91, any sum paid as subscription to any deposit scheme of the National Housing Bank is also deductible.
- Payments in respect of purchase or construction of a residential house: This provision has been introduced w.e.f. the assessment year 1988-89 onwards. Any sum paid (up to a maximum of Rs. 10,000) through an individual or a HUF for the residential house property the construction of which is completed after 31.3.1987, are eligible for deduction, provided such payments are made towards or through method. of :

  tttt. Any installment of amount due under any self-financing or other scheme of any development authority or housing board occupied in the construction and sale of house property on ownership foundation, or

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

  vvvv. Re-payment of the amount borrowed through the assessee from

    i. The Central Government or any State Government, or
    ii. Any bank, including a cooperative bank, or
    iii. The Life Insurance Corporation, or
    iv. The National House Bank, or
    v. Any public company shaped and 'registered in India with the main substance of carrying on the business of providing extensive-term finance for construction
    vi. Or purchase of houses in India for residential purpose and approved in this regard, or
    vii. Any, company in which the public are considerably interested or any cooperative society, where such company or cooperative society is occupied in the business of financing the construction of houses, or

viii. The assessee's employer where such employer is a public company or a public sector company or a University recognized through law or a college 'affiliated to such a University or a local authority.

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

There are though, sure payments which are not eligible for deduction. They contain :

- Admission fees, cost of share or initial deposit paid through a shareholder of company or a member of a cooperative society to become such shareholder or member, or
- Cost of the land, except where the construction for the purchase of the house property is a composite amount and the cost of land cannot be ascertained separately, or
- Cost of any addition or alteration to or renovation or repair of the house property which is accepted out after the house property or any part thereof has either been occupied through the assessee, or any expenditure in respect of which deduction is allowable while computing income from house property u/s 24. The house property for which deduction is so claimed necessity not be transferred through the assessee before a era of 5 years from the possession of the similar. If he docs so the deduction allowed will be added back as income from other sources in the previous year in which the transfer takes lay.

Based on Net Savings

In Respect of Deposits in National Saving Scheme etc, (See. 80-CCA).

Deduction is allowed in full in respect of the following deposits/payments in the year of such deposits/payment:

- Deposit in accordance with the notified National Savings Scheme.

- Payment towards a notified annuity plan of the, Life Insurance Corporation of India. (So distant the 'Jiwan Dhara' and 'Jiwan Akshy' plan of the LIC has been notified,)

The qualifying amount for such deduction is

For assessment year 1988-89 actual or Rs. 20.000 whichever is less

For assessment year 1989-90	-do-	Rs. 30,000	-do-
For assessment year 1990-91	-do-	Rs. 30,000	-do-
For assessment year 1991-92 and subsequent years	-do-	Rs. 40.000	-do-

The interest accrued on the deposits shall not be chargeable to tax from year to year. Whenever any amount in respect of which deduction was allowed in the year of deposit is withdrawn, the amounts jointly with interest withdrawn through the tax-payer is treated as the income of the tax-payer of the year in which withdrawal is made and charged to tax beside with other income at the normal rate applicable to him. If, though, the tax-payer dies without creation the withdrawal and the withdrawal is made through his legal representatives, the withdrawal having not been made through the tax-payer himself will not be charged to tax. With effect from the assessment year 92 if the deposit was made through the HUF and the HUF is partitioned, the individual member who creates the withdrawal will be taxed in respect of the amount withdrawn through him. The similar rules arc applicable when the amount of annuity is received from the LIC under a policy in respect of which deduction was allowed when payment was made through the tax-payer.

In Respect of Investment in Equity Connected Savings Scheme (Sec. 80. CCB)

Where an individual or a HUF acquires Units of Unit Trust of India or any other recognized mutual finance under any plan which is formulated under the notified equity connected saving scheme, he shall be entitled to full deduction in respect of such investment subject to the maximum of Ms. 10,000.

As in the case of deposit under National Savings Scheme, whenever any such investment is returned to the assessee in whole or in part either through method of repurchase of the unit or on termination of the plan in any previous year, the whole amount (including the accretion) received back will be charged to tax as the income of the previous year in which it is received.

If in the meantime, a partition is made in the HUF or dissolution takes lay in the. AOP (Association of Persons) which initially made the investment, the return of investment will be taxable in the hands of the person who takes it.

Based on Income from Specified Investments (Sec. 80-L)

Deductions, subject to the monetary limit below is allowed in respect of following investment income —

- Interest on any security of Central Government or State Government.
- Interest on notified debentures issued through sure authorities.
- Interest on National Savings Certificate VI and VII Issues.
- Interest on deposits under any notified Scheme of the Central Government.
- Interest on deposits under Post Office (Monthly Income Account) Rules, 1987,
- Interest on deposits with Banking companies including co-operative banks.
- Interest on deposits with financial organizations providing extensive-term finance for industrial development approved for the purpose of Section 36(l)(viii).
- Interest on deposits with authority constituted for satisfying the housing needs etc.
- Interest on deposits with co-operative societies.
- Dividend on shares of co-operative societies.

- Interest on deposits with or dividend from shares of a public company providing extensive-term finance for construction or purchase of residential houses and which is approved for the purposes of Section 36(1)(viii).
- Income from Units of recognized Mutual Funds.
- Income from Units of Unit Trust of India.
- Interest on deposits under National Deposits Scheme framed and notified through the Central Government,
- Dividend on shares of Indian companies.

The deduction is limited in the aggregate to Rs. 7,000,

Though, if the Gross Total Income comprises Items (xi), (xii) and (xiv) an additional deduction can be allowed in respect of these amounts to the extent deduction in respect of such income is not fully allowed within the limit of Rs. 7000. Such additional deduction will not exceed Rs. 3000.

Further if deduction in respect of income from interest on deposits under National Deposit Scheme and dividend from shares of Indian companies is not fully allowed within the above limits of Rs. 7000 and Rs. 3000 a further additional deduction can be allowed to the extent of unhallowed location. This further additional deduction will not exceed Rs. 3000.

The net effect is that with properly planned investment, one can get a total deduction of Rs. 13.000.

DEDUCTIONS FOR SURE PERSONAL EXPENDITURE

Under Section 80-D, 86-DD and 80-GG of IT Act 1961 some deductions are allowed in respect of personal expenditure. Let us now talk about these three sections one through one.

For Medical Treatment (Sec. 80-D)

Deduction is allowed in respect of any sum paid out of chargeable income through cheque towards an insurance policy taken on the health of the assessee or his wife/husband or dependent parents or dependent children.

The deduction is subject to a maximum amount of Rs. 3,000, provided the scheme for insurance is framed through GIC and approved through Central government under Section 80-D the Income Tax Act 1961.

Maintenance of Handicapped Dependents (Sec. 80-DD)

Deduction is allowed to a resident individual in respect of expenditure incurred for medical treatment (including nursing), training and rehabilitation of a handicapped relative who is dependent upon him and is not dependent on any other person for support or maintenance. A handicapped relative means a relative who is suffering from permanent physical disability (including blindness) or who is subject to mental retardation. They should be of the nature specified in I T. Rules and should be certified as such through a physician a surgeon, an oculist or a psychiatrist working in a government hospital. Further, it should have the effect of reducing considerably such person's capability for normal work or engaging in gainful employment or job.

The deduction will be allowed of a fixed sum of Rs. 0,000. This deduction is irrespective of actual expenditure. It applies from the assessment year 1991-92. Deduction is not admissible in cases where the total income before deduction under this section exceeds Rs. 1 lakh.

For Payment of House Rent (Sec. 80-GG)

Deduction is allowed to an assessee in respect of payment of rent of the premises occupied through him for his own residence. This deduction is permissible of an amount through which the rent paid exceeds 10% of the total income.

Therefore , if total income is Rs. 50,000 and rent paid is Rs. 7,000, permissible deduction will be 7,000 — 10% of 50,000, i.e. Rs. 2.000.

But even the amount calculated as restricted to —

- Rs. 1,000 per month or
- 25% of total income whichever is less.

Therefore , in the above case if the rent paid was Rs. 20,000, the excess in excess of 10% of total income, would have been Rs. 15,000 which would have been further restricted to Rs. 1,000 per month, i.e. Rs. 12.000.

This deduction is not allowable to an employee getting house rent allowance from his employer, the exemption in respect of which is governed through the provisions of Section 10(13A).

Total income for this purpose means the gross total income reduced through all the deductions under this Section,

DEDUCTIONS FOR ENCOURAGING VOLUNTARY PARTICIPATION IN CHARITABLE AND SOCIALLY DESIRABLE BEHAVIORS

The Income Tax Act, 1961 also allows sure deduction for the contribution made,' in the charitable and socially desirable behaviors . These arc explained in Section IDG and 80-GGA.

Contribution to Charitable Trusts/Associations/Societies (Sec. 80-G)

- Contribution made to following trusts, associations or societies qualify for deduction —

xxxx. National Defense Finance

yyyy. Jawaharlal Nehru Memorial Finance

zzzz. Prime Minister's Drought Relief Finance

aaaaa. Prime Minister's National Relief Finance

bbbbb. Prime Minister's Armenia Earthquake Relief Finance

ccccc. National Children's Finance

ddddd. Indira Gandhi Memorial Trust

eeeee. Any other finance or institution to which Section 80-G applies

fffff. Government or any local authority to be utilised for charitable purpose

ggggg. other than promotion of family scheduling

hhhhh. Housing authorities mentioned in Section 10(20A)

iiiii. Government or such local authority, institution or association as are approved if the payment is for promoting/family scheduling

jjjjj. For renovation or repairs of such temple, mosque, guardwara, church etc. as are notified to be of historic, archaeological or artistic importance.

- The deduction will be 100% of the qualifying amount in respect to payments mentioned/in (iv), (v) and (xi) and 50% of the qualifying amount in respect of the rest.
- The qualifying amount will be determined as under :

kkkkk. If the aggregate of the amount paid is less than Rs. 250, no deduction will be allowed.

lllll. If the aggregate of items referred in items (viii), (ix), (x), (xi) and (xii) exceeds 10% of the Gross Total Income (as reduced through all deductions except this one) the aggregate qualifying amount for these items will be restricted to 10%.

- Concerning thing mentioned in (viii), i.e., contribution to any other finance or institution to which this section applies, it is necessary that the finance etc. should comply with following circumstances :

mmmmm. The income of such finance, institution etc, should be exempt through cause of its charitable other provisions exempting income viz. Educational organizations [10(22)], hospitals etc., [10(22a)], sports associations [10(23)], regimental finance recognized through armed forces [10(23aa)] or other funds mentioned in section 10(23c);

nnnnn. The rules' should not permit application on transfer of any part of income or asset for any purpose other than charitable purposes;

ooooo. The institution etc. Should not be for the benefit of any scrupulous community;

ppppp. The institution etc. Should uphold regular accounts of income and expenditure;

qqqqq. The institution etc. Should be constituted either as a public charitable trust or registered under societies registration act or under section 25 of indian companies act or should be a university recognized through law or should be any other educational institution recognized through or affiliated to any university or an institution approved for the purpose of section 10(23c) or an institution financed through the Government or local authority.

Contribution to Sure Approved Organizations (Sec. 80-GGA)

- Deduction is allowed in respect of—

rrrrr. Contribution to an approved scientific research association or to an approved University, College or other Institution to be used for scientific research.

sssss. Contribution to an association or institution having the substance of undertaking an approved programme of rural development.

ttttt. Contribution to an approved association or institution having the substance of undertaking an approved programme of conservation of natural possessions or afforestation.

uuuuu. Contribution to notified finance for afforestation.

vvvvv. Contribution to notified Rural Development Finance.

wwwww. Contribution to an association or institution which has as its substance the training of persons for implementing programmes of rural development.

- These deductions are not to be allowed to an assessee deriving income from business or profession. In his case, these contributions are allowed in the computation of the business income.

DEDUCTIONS FOR ECONOMIC GROWTH

In order to encourage the new industrial units for the overall balanced economic growth of the country, the IT Act 1961 allows sure deductions. These deductions are as follows.

For Setting up New Industrial Units Anywhere (Sec. 80-1)

- Deduction is allowed out of income from a new industrial undertaking at the following ratks:

  xxxxx. If the industrial undertaking begins to manufacture or produce articles or operate cold storage prior to 1.4.1990 ... 20% of the profit

  yyyyy. If these operations start on or after 1,4-. 1990 ...25%

- These deductions are allowed in the initial year in which the industrial undertaking begins manufacture and the following seven years. In effect, so, the deduction is allowed in 8 assessment years. If, though, these operations commence on or after 1.4.1990, the deduction will be allowable for initial years and the following nine years. This means that deduction will be allowed for 10 assessment years.

- Deduction is allowed only to those undertakings which fulfill all the following circumstances:
    zzzzz. The new undertaking is not shaped through the splitting up or reconstruction of already existing business;
    aaaaaa. It is not shaped through transfer to a new business of machinery or plant previously used for any purpose. This condition will not apply in the case of second-hand imported machinery which at no time was used in india and in respect of which no depreciation was allowed or allowable in india. This condition will also not apply if the total value of transferred machinery or plant does not exceed 20% of the total value of machinery or plant used in that business;
    bbbbbb. The new undertaking begins operating at any time within a era of fourteen years after that following the 31st day of march, 1981;
    cccccc. The new undertaking, if it is not a small level industrial undertaking, produces any article other than those mentioned in eleventh schedule (eleventh schedule consists of non-priority items such as cigarettes, liquor, cosmetics etc.).
    dddddd. The new undertaking employs ten or more workers if the manufacturing procedure is accepted on with the aid of power and twenty or more workers if the procedure is accepted on without the aid of power.

For Setting up New Industrial Units in Backward Areas (Sec. 80-WW)

- Deduction is allowed out of profit from an industrial undertaking or hotel set up in any backward area at the rate of 20% of such profit for a era of ten years beginning with the year in which the industrial undertaking begins manufacture or hotel starts functioning. Backward area means such area which has been notified through the Central

Government as backward area having regard to its stage of development.

- This deduction applies only to those undertakings which fulfill the following circumstances:
    - eeeeee. It begins to manufacture or the hotel begins to function after 31st December, 1970;
    - ffffff. It is not shaped through splitting up or the reconstruction of a business already in subsistence in any backward area;
    - gggggg. It is not shaped through the transfer to a new business of machinery or plant previously. This condition will not apply if the total value of transferred machinery or plant does not exceed 20% of the total value of machinery or plant used in the business;
    - hhhhhh. It employs at least ten workers if the manufacture is with the aid of power and at least twenty workers if the manufacture is without the aid of power:
    - iiiiii. in the case of hotels, they should be approved for the purpose through the Central Government.
- If the industrial undertaking is also a small level undertaking set up in a rural area and has claimed deduction under Section 80-HI-IA (to he discussed later in 11.5.3), this deduction will not be allowed.
- This deduction will not be allowed in respect of undertakings or Hotels beginning manufacture (in the case of hotels starting to function) on or after 1st April, 1990. This means that the deduction has been discontinued in respect of undertakings/hotels coming into subsistence now.

For Setting up Small Level Units in Rural Areas (Sec. 80-HHA)

- This deduction is allowed out of profits and gains of new small level industrial undertaking set up in rural areas. The undertaking should be one which begins to manufacture after 30th September 1977 and which complies with all other circumstances which are laid down for the undertakings qualifying for deduction under Section 80-HH (Refer 11.5.2—Para 2).

- This deduction is also admissible for a era of ten previous years beginning with the previous year in which the industrial undertakings begin to manufacture or produce articles. The amount of deduction is 20% of the profits or gains derived from such undertaking.
- If, though, an undertaking qualifies for deduction under Section 80-HH (applicable to undertakings in backward areas) also and claims deduction under that Section, no deduction will be allowed under this Section.
- This deduction will not be allowed if the undertaking begins to manufacture articles on or after 1st April, 1990.

For Encouragement to Poultry Farming (Sec. 80-JJ)

Deduction is allowable out of profit and gains of the business of poultry fanning at the rate of 33 1/3% thereof. This deduction is allowable for and from the assessment year 1990-91.

DEDUCTIONS IN RESPECT OF EARNINGS IN FOREIGN SWAP

There are sure deductions which are allowed in order to boost exports and earn foreign swap. These are explained u/s 80-HHB, 80-HHC, SO-HHD, 80-HR, 80-HRR, 80-HRRA.

In Respect of Income from Project Exports (Sec. 80-HHB)

- This deduction is allowable only to an individual who is resident in India.

- The deduction is allowable out of the profits and gains derived from the business of—
    - jjjjj. Execution of foreign project, or
    - kkkkkk. Execution of any work forming part of a foreign project undertaken through any other person.
    - llllll. In both the cases, the contract should be with the foreign government or any foreign authority or agency or a foreign enterprise.
- The amount of allowable deduction is 50% of the profits and gains from the execution of such projects/work,
- The deduction is allowable only if the consideration for execution of such project/work is payable in convertible foreign swap.
- The deduction is allowable subject to the fulfillment of following circumstances:
    - mmmmmm. Separate accounts for such projects/works should be maintained and got audited through a Chartered Accountant.
    - nnnnnn. A reserve of an amount equal to 50% of the profit from such project work should be created through credit to 'Foreign Projects Reserve Account' This reserve should be utilised in the after that five years for the purposes of the business but not for sharing through method of profit. If the amount is utilised within five years for any other purpose or for sharing as profit, the deduction shall be measured to be wrongly allowed and the assessment shall be rectified to withdraw such deduction.
    - oooooo. At least 50% of the profits or gains from such project/work should be actually brought in India in convertible foreign swap within six months of the end of the previous year. If, for unavoidable reasons, it is not possible to do so, the Commissioner/Chief Commissioner can extend this time. Where the amount credited to Foreign Project Reserve Account--or the amount actually remitted to India is less than

50% of such profits the deduction is restricted to the amount credited or actually brought into India whichever is less.

In Respect of Income from Export of Goods or Mercandise (Sec. 80-HHC)

- This deduction is allowable only to an individual who is resident in India.
- The deduction is allowable out of profit derived from the export of goods or merchandise. It, though, does not apply to profit derived from export of (i) mineral oil, and (ii) minerals and ore.
- Up to the assessment year 1990-91 the deduction allowable is of the whole profit derived from export. For this purpose, the profit derived from export is to be computed as under:

  pppppp. If the assessee's turnover is from export only, the whole profit computed under the head "Profits and gains of business or profession" will be the profit derived from export.

  qqqqqq. If only part of the total turnover is from export the proportionate amount of profit computed under the head "Profit and gains of business and profession" will be the profit derived from export.

i)	Domestic Sales	10,00,000
ii)	Export Sales	20,00,000
		30,00,000

and the total profit under the business head is Rs. 3,00,000, the profit derived from export will be

$$3{,}00{,}000 \times \frac{20{,}00{,}000}{30{,}00{,}000} \text{ i.e., Rs. } 2{,}00{,}000$$

- With effect from the assessment year 1991-92, the amount of deduction depends upon the sale consideration brought in India. If the whole consideration for export turnover is brought into India in convertible foreign swap within six months of the end of previous year or within such extended time as several be permitted through the Commissioner/Chief Commissioner, the whole profit computed in the manner described in Para 3 will be allowed as deduction. If, though, only a part of the total consideration is brought in India, only the proportionate amount will be allowed as deduction. Total Turnover shall not contain:

rrrrrr. Any sums receivable through an exporter through method of profit on sale of a license granted under the Imports (Control) Order 1955. Cash received or receivable against export under any scheme of the governments assistance.

ssssss. Repayment of any duty of customs for instance:

Profit derived from export	2,00,000
(computed in the manner mentioned in para 3)	
Export turnover	20,00,000
Convertible foreign exchange brought in India	15,00,000

The deduction will be limited to

$$2,00,000 \times \frac{15,00,000}{20,00,000} = \text{Rs. } 1,50,000$$

- This deduction is also accessible to a supporting manufacturer who, instead of creation a direct exports himself, exports through an Export House or Trading House. In this case the Export House or Trading House should issue a certificate of disclaimer that they have in respect of such export turnover not claimed the benefit of Section 80-HHC. The benefit accessible to the Export House/Trading House will in such cases be proportionately reduced.

In Respect of Earnings of Tour Operators and Hotels (See. 80-HHD)

- The following deduction is allowable to resident person occupied in the business of approved hotels, tour operators or travel agents in respect of profit derived from services provided to foreign tourists :
  - tttttt. 50% of profit derived from services provided to foreign tourists, plus
  - uuuuuu. so much of the remaining 50% as has been debited to Profit and Loss Account and credited to a reserve account.
- The amount transferred to reserve account has necessarily to be utilised within after that five years for following purposes:
  - vvvvvv. Construction of new approved hotels or expansion of facilities in existing approved hotels
  - wwwwww. Purchase of new cars and new coaches
  - xxxxxx. Purchase of sports equipments for mountaineering etc.
  - yyyyyy. Construction of conference or convention centers
  - zzzzzz. Provision of such new facilities for growth of Indian tourism as may be notified through the Central Government.

For AY 1991-92 and onwards the amount brought in or received in Convertible Foreign Swap (CFE) within 6 months from the end of PY will qualify for such deduction. It is further provided that the deduction will be restricted in the proportion as the receipt in CFE received in or brought in, if the reserve is utilised for any other purpose, it shall be deemed to be the profit of the year in which the amount was so utilised and shall be charged to tax. If the similar remnants unutilized in the after that five years, the unutilized amount shall be deemed to be the profit of the sixth year and shall be charged to tax.

Profits derived from services provided to foreign tourists will be computed as under:

- In cases where the business consists exclusively of services to foreign tourists resulting in receipts in convertible foreign swap, the whole profit computed under the head 'Profit and gains of business or profession'.

- Where only part of the total behaviors consist of services to foreign tourists resulting in receipt of convertible foreign swap, only that part of the business profit which is in proportion to such receipts and total receipts.

In Respect of Remuneration of Teachers, Professors etc. (Sec. 80-R)

An Indian citizen deriving remuneration for services rendered outside India in the capability as a professor, teacher or research worker in any University or, other educational institution recognized outside India is entitled to following deductions:

- Up to assessment year 1990-91: ... 50% of such remuneration for a maximum era of 36 months.
- For and from assessment year 1991-92: ... 50% of remuneration or 75% of such remuneration as is actually brought into India, whichever is higher. The condition of 36 months is no longer applicable.

In Respect of Income Earned through Artists, Authors and Play writers (Sec. 80-RR)

An Indian resident deriving income from outside India in exercise profession of an author, playwright, artist, musician,. actor or sportsman (including an athlete) is entitled to deduction as under:

- Up to assessment year 1990-91: ... 25% of such remuneration if the similar was brought into India
- For and from assessment year 1991-92: ... 50% of remuneration or 75% of such remuneration as is brought into India, whichever is higher.

In Respect of Income of Sure Technicians Rendering Services Abroad (Sec. 80-RRA)

- An Indian citizen being a sponsored Central or State Government employee or a technician having specialized knowledge and experience in specified meadows is entitled to deduction in respect of any remuneration from foreign sources.
- The deduction will be of an amount equal to 50% of the gross remuneration or 75% of such remuneration as is brought into India, whichever is higher. Earlier such deduction is allowed for a maximum era of 36 months if the services were continuous but with effect from 1.4.91 this condition has been removed.
- The deduction to persons other than the sponsored Central or State Government employees is allowed only if the conditions and circumstances of his services outside India are approved through the Central Government

DEDUCTIONS IN THE CASE OF TOTALLY BLIND OR PHYSICALLY HANDICAPPED RESIDENT PERSONS (SECTION 80-U)

A deduction of Rs. 15,000 is allowed to a resident individual who is—

- Totally blind, or
- Suffers from permanent physical disability specified in the rules which has the effect of considerably reducing his capability to engage in gainful employment or job. Or
- Subject to mental retardation to the extent specified in rules and which considerably reduces his capability to engage in gainful employment or job.

REVIEW QUESTIONS

- What is gross total income? How do you compute it?
- Explain the concept of deductions from gross total income.
- What are circumstances for deduction?

CHAPTER 12

Computation of Total Income

STRUCTURE

- Learning objectives
- Steps in computation of total income
- Head wise computation of income
- Computation of gross total income
- Deductions under chapter via
- Review questions

LEARNING OBJECTIVES

After learning this chapter, you should be able to:

- Compute income under individual heads;
- Compute gross total income;
- Calculate the losses to be set off and accepted forward and set off in succeeding years, and finally;
- Compute the total income.

STEPS IN COMPUTATION OF TOTAL INCOME

The following stages are involved in the computation of total income:

- Computation of taxable income from each source under a scrupulous head;
- Computation of-taxable income under each head;
- Computation of gross total income;
- Ascertaining the amount of deductions admissible under Chapter VIA; and
- Arriving at the Total Income.

HEADWISE COMPUTATION OF INCOME

Under the scheme of Indian Income Tax Act, the income of a tax-payer falls in one or more of the following heads of income :

- Income from salaries
- Income from house property
- Profits and gains of business or profession
- Income from capital gains
- Income from other sources.

Specific provisions are contained in the Act for computation of income under each head of income. As a broad common principle, in the absence of any specific mention of allowances or disallowances, income under each head is computed through deducting from the gross profit/receipts the expenses of revenue nature which are incidental to business (Section 37) in case of business income and which are incidental to earning the income in other cases.

Income from dissimilar sources under each 'head of income' is to be separately computed. For instance, a person may be the owner of more than one business in which case, the profit of each business will be computed separately and total of all will be the income under the head 'profits and gains from business or profession'. Likewise, a person may earn capital gains from more than one transaction in which case gains arising from each transfer are to be separately computed and the total of such gains will come under the head 'Capital gains'.

If there is income from one source and loss from another source falling within the similar head of income the loss will be adjusted (technically recognized as set off) against the income of another source and only the net figure will be the income under the head. If, for instance, there is profit of Rs. 50,000 from business 'A' and loss of Rs. 30,000 from business 'B', it is only Rs. 20,000 after such intra-head adjustment that will be 'profit from business'.

Speculation loss is, though, allowed to be set off only out of profit from another speculation business and not from the profit of any other business.

COMPUTATION OF GROSS TOTAL INCOME

Having computed income under individual heads, the after that step is the aggregation of income under all the heads. If the income computed under any head or heads is a loss, such loss is allowed to be adjusted against the income under other heads. For instance, if the computation under the head 'Profit and gain of business' is a profit of Rs. 1,00,000 and there is a loss of Rs. 30,000 under the head ‘income from house property' the loss can be adjusted against the business income with the result that there will be profit from business Rs. 70,000 only.

The loss arising from speculation business cannot be set off either out of profit of any other business or income under any other head. After the inter-head set off mentioned in The after that step is to allow set off of the past losses under business and capital gains which could not be set off in earlier years and hence accepted forward in those years. Such a set off is, though, subject to the following circumstances:

- Loss accepted forward can be set off against income under the similar head, if any.
- Accepted forward speculation loss can be set off against speculation profits only.
- Business loss can be set off against the business income only if the similar business is not discontinued,
- Loss under the head business can be accepted forward to eight succeeding assessment years only but unabsorbed depreciation can be accepted forward without any limitation as to time. Therefore , if the loss is accepted for an assessment year beyond eight years, no set off is permitted.
- Loss arising from extensive-term capital gain can be accepted forward to eight succeeding
- Assessment years for set off against income under the head 'capital gains' only.

In the instance if there was a accepted forward business loss of Rs, 60,000, it will be set off against business income of Rs. 70,000 therefore reducing the income under this head is Rs. 10,000 only.

In case the accepted forward business loss was Rs, 70,000 the whole loss would have been resulted in nil income under the business head. If the accepted forward business loss was Rs, 80.000, it would have been set off to the extent of Rs. 70,000 and the remaining loss of Rs. 10,000 accepted forward for set off in succeeding years. This presumes that the similar business is still sustained in this year and the accepted forward loss IS not more than eight years old.

DEDUCTIONS UNDER CHAPTER VIA

After that step for calculation of taxable income is the deduction. The Gross Total Income is reduced through the deductions mentioned in Chapter VIA. I t is significant to note that such deductions cannot exceed the Gross Total Income. After the deductions are made the resulting figure is total income which is subjected to tax at the rate or rates mentioned in the Finance Act.

REVIEW QUESTIONS

- What steps are involved in calculation of total taxable income of an individual'?
- Explain the steps in computation of total income.
- What is head wise computation of income?

CHAPTER 13

Filing of Return and Tax Authorities

STRUCTURE

- Learning objectives
- Return of income
- Self assessment
- Consequences of delay in filing return
- Consequences of incorrect information
- Processing of returns
- Re-assessment of income
- Tax authorities
- Review questions

LEARNING OBJECTIVES

After learning this chapter you should be able to:

- Select the shapes of return and due dates for filing return;
- List the information to be provided in the return;
- Create self-assessment of your income and describe, deduct tax at source and advance tax;
- Enumerate the consequences of delay in filing the return and incorrect information;
- List the steps of processing of returns;
- Enumerate the reasons for reassessment of income; and
- List the tax-authorities and their functions.

RETURN OF INCOME

For quantification of tax liability every person whose total income exceeds the exemption limit (which for and from the assessment year 1991-92 is Rs. 22,000) is required to file a statement of his total income technically described 'return of income' within the prescribed time to the prescribed income tax authority. This return shapes the foundation for determining the total income and arriving at the tax payable or refundable to the assessee. After receipt of the return, the tax authorities may decide to accept the information furnished therein as true and calculate the tax liability based on such information only. In other cases they may call upon the tax-payer to substantiate the information and proof to satisfy the authorities in relation to the correctness and completeness of the information supplied in the return. They may themselves create self-governing enquiries, inquire questions from the tax-payer and seek such further information as may be measured necessary for determination of correct assessable income. The total income is then determined after creation such modification in the income stated in the return as may be warranted through the proof 36 furnished through the tax-payer and enquiries made through the tax authorities.

Filing of the Return of Income every year is the first step in the proceedings for completion of assessment and determination of tax liability. It is an significant document which needs to be filled in very cautiously and accurately.

Furnishing of inaccurate information or omission to disclose any material information may entail penal consequences and may even subject the tax-payer to the. risk of criminal prosecution.

Selection of Correct Form of Return

There are four kinds of income-tax returns. One of these returns is relevant for an osscsscc and the relevance is determined through the status (company or other) of the assessee and through the sources from which income. is derived through him, These are :

- ***Form No. 1:*** For companies (except those claiming exemption under Section in respect of income from property held for charitable and religious purposes).

- ***Form No. 2:*** For assesses (other than companies and those claiming exemption under Section 11) deriving income from business of profession,
- ***Form No. 3:*** For assesses (Other than companies and those claiming exemption under Section II) not deriving income from business or professions.
- ***Form No. 3A:*** For assesses including companies claiming exemption under Section 11 in respect of income from property held for charitable and religions purposes.

These returns arc accessible in the income-tax officers free of charge.

Due Dates for Filing the Return

The last dates for filing the return of income with the tax authority having jurisdiction in excess of an assessee's case arc laid clown in Section I39(1) of the Income Tax Act and determined through the status (company or others) of the osscssee, sources of income, (whether from business or profession or from sources other than 'business or profession') and whether the accounts are required to be audited under any provision of the Income Tax Act or any other law, The due dates are—

Kind of assessee and Date in the assessment year

- Assesses (Other than companies) not deriving income from business or profession and in respect of whose accounts where is no legal requirement for getting the accounts audited.[30th June]
- Assesses (Other than companies) deriving income from business or profession, in respect of which there is no legal requirement of getting the accounts audited. [31st August]
- Assesses (Other than companies) accounts of which arc required to be audited under the I.T. Act or any other law, Under the I.T. Act accounts of a business are required to be compulsorily audited if the

total sales, turnover or gross receipt exceeds 40 lakhs rupees. Accounts of persons carrying on profession arc required to be audited if the gross receipts exceed 10 lakh rupees. A charitable trust having income of more than Rs. 25.000 is also required to get its accounts audited. [31st October]

- Companies [31st December]

If the assessee is a partner in any firm, the due date of filing the return will be the similar which is the due date for the firm in which he is the partner.

Under the Income Tax Act if the income of an assessee exceeds the exemption limit he should file a return of income before the due date applicable to him.

If, though, for any cause he is not able to do so, he can still file the return after the due date but before the expiry of one year from the end of the relevant assessment. Assessment of individual war or before the completion of assessment whichever is earlier. If for instance, the assessee is a person not deriving income from business and accounts are not required to be audited under any law. he is supposed to file the return through 30th June of the assessment year. For income craned in the previous year 1989-90 (i.e., from April 1 1989 to March 31, 1990) the relevant assessment year will be 1990-91 and the return will be due on June 30, 1990. If for any cause he has not been able to file the return through June 30, 1990 he can file the return thereafter hut in any case the return should be filed before the expiry of one year from the end of 1990-91 i.e. before one year from March 31, 1991. This means that the return should be filed through March 31, 1992 but if, in the meantime, an ex parte assessment has already been completed for failure to file the return say on September 15, 1991. the right to file the return will lapse on September 15, 1991. Please keep in mind that although the assessee can file the return even after the due date, this will be subject to an interest at the rate of 2% per month for the era calculated from the due date to the date of actual filing.

If the return is not filed, the assessing officer can, acting under Section 142(I), serve the assessee with a notice after the expiry of the due date asking him to file the return within the time specified in the notice.

If after filing the return the assessee discovers any omission or any wrong statement therein, he can furnish a revised return anytime before the expiry of one year from the end of the relevant assessment year. lf, though, an assessment has been completed in the meantime, the right to file the revised return will lapse.

Correct and Complete Information

The information furnished in the return is required to be verified at the end in order to be sure that it is true and correct. The verification is an affirmation and if it is establish to be false, one is subject to severe consequences including prosecution. Separately from being correct, it is necessary that the return is complete in all compliments. Nothing which has a bearing on the computation of correct assessable income should be suppressed i. e. every information which effects the assessable income directly or indirectly should be disclosed. Wherever possible, necessary proof should be enclosed with the return. To illustrate the assessee should attach the following documents to substantiate the information under dissimilar heads:

Salaries:

- The employer's certificate giving details of remuneration.
- The employer's certificate showing tax deducted of source.

House Properties:

- A statement showing how the income shown in the return has been arrived at.

- Details of interest payment.

Business and Profession:

- In cases where regular accounts arc maintained:
  - aaaaaaa. Copy of Trading/Manufacturing Account.
  - bbbbbbb. Copy of Profit and Loss Account
  - ccccccc. Copy of Balance Sheet
  - ddddddd. Details of depreciation claimed
  - eeeeeee. Auditor's statement, if accounts are audited
  - fffffff. Details of payment for taxes etc. which are allowed on cash foundation only.
- In cases where regular accounts are not maintained:
  - ggggggg. Statement showing how the income has been arrived at
  - hhhhhhh. Details of depreciation claimed.

Other Sources:

- iiiiiii. In case of income from dividend—the dividend warrants.
- jjjjjjj. In case of income from interest—interest warrants or details of interest earned beside with certificate of tax deducted at source, if any.
- kkkkkkk. In case of income from any other source like royalty, winning from lotteries, income from sub-letting etc—necessary details thereof beside with the certificate of tax deduction, if any.

Capital Gains:

- lllllll. Details of capital gains derived giving the computation of such gains.
- mmmmmmm. Proof of re-investment of capital gain/sale proceeds as a result of which capital gain is not to be fully or partially charged to tax.

nnnnnnn. Proof of deposit in specified bank account under the notified scheme.

In All Cases:

- Proof in respect of deductions claimed under Chapter VIA, e.g.;

ooooooo. U/S 80C/88”: Life Insurance receipts, receipts for deposit in Public Provident Finance, details of NSCs purchased etc.

ppppppp. U/S 8OCC/88A: Details of investment in eligible issues of capital or in relevant schemes of mutual funds.

qqqqqqq. U/S 80CCS/80CCB: Details of deposit under National Saving Scheme or notified annual plans or investment under notified equity connected saving scheme.

rrrrrrr. U/S 80D: Medical insurance receipt.

sssssss. U/S 8ODD: Certificate from competent doctor concerning permanent physical disability.

ttttttt. U/S 8OG/GGA: Receipts for donations/contributions made.

uuuuuuu. U/S 80GG: Receipts for rent payment.

vvvvvvv. U/S 80R & .80RR & 80RRA: Proof of remuneration etc. in foreign currency and proof of money brought in the country. In case of deduction under Section 80RRA, copy of approval of the agreement should be enclosed.

An assessee is recognized in the Income Tax Department through the Permanent Account Number (PAN) allotted to him. Under Section 139A if the total income of an assessee exceed the exemption limit (which is Rs. 22,000 for and from the assessment year 1091-92) and he has not already been allotted a PAN, he should apply to his assessing officer for allotment of PAN.

This number should be clearly mentioned in the Return form and all correspondence with the department. Earlier the tax-payers were recognized through the Common Index Register number (GIR No.) and in the middle era both the numbers are in use till GIR is totally replaced through PAN.

SELF ASSESSMENT

Although the income of the financial year (technically described 'Previous Year') is finally assessable for the after that financial year (technically described 'assessment year'), the Income tax Act contains provisions for collection of tax in the previous year itself.

Such collection is provisional in nature in the sense that the similar is measured to have been paid towards the final liability to be determined on the foundation of return or on completion of assessment for the relevant assessment year, Accordingly whatever taxes are paid through the assessee under these provisions are adjusted against the tax finally determined and the balance amount is payable through or refundable to the tax-payer.

Tax is composed in the previous year itself through. either or both of the following methods:

- ***Tax deduction at Source (T.D.S.):*** This system requires the person creation payment for salaries, interest on securities, interest other than interest on securities, insurance commission, dividend, winnings from lotteries or horse races etc. or those creation payments to contractors for work executed through them or to non-residents, to deduct tax at prescribed rates and to pay the net amount only. The tax so deducted is to be deposited with the Government which is measured as the tax paid through the recipient for which credit is to be allowed to him in the final determination. For instance, if an assessee earns an interest of Rs. 10,000 from A, the payer, i.e. A will, at the time of payment or credit to the assessee's account, deduct tax at the prescribed rate of 10% and pay only Rs. 9,000 to him. He will deposit this Rs, 1,000 with the Government and issue a certificate to the assessee. The assessee will contain an income of Rs. 10,000 from interest in his total income. Suppose his total income including this interest is Rs. 50,000 on which tax works out to Rs. 7,600, the tax payable through him will be Rs. 7,600 minus Rs. 1,000 tax already paid through method of deduction and the balance of Rs. 6,600 only will be required to be paid. In the said instance if the total income is Rs. 25,000, the tax will work out to Rs. 600 only and since Rs. 1.000 has already been paid as TDS, the assessee will be entitled to a refund of Rs. 400.

- ***Advance Tax :*** If an assessee derives income from sources in respect of which there is no system of deduction of tax at source, he is required to create an estimate of total income which he will earn in the previous year. Such income is technically described income of the 'current year'. On such estimated income he is required to work out the tax at the rates prescribed in the Finance Act. reduce such tax through the amount of tax deducted at source, if any, and pay at least 20% of the balance tax through 15th September, 50% (after adjusting the first installment) through 15th December and 100% (after adjusting the earlier two installments) through 15th March of the previous year. Such payment is recognized as 'advance tax' for which also credit is allowed in determining the tax finally payable through or refundable to the assessee.

Self-assessment

Section 140A of the Income Tax Act requires that before an assessee submits his return to the department, he should discover out the tax payable on the total income and interest payable for short payment of advance tax or for delay in submission of return. From such tax and interest he should deduct the TDS and the advance tax paid if any. If there is any amount still payable, the similar should be paid and the Chelan for such payment should be enclosed with the return. This is recognized as 'self-assessment', The self-assessment tax beside with 'TDS' and 'Advance Tax' is deemed to be tax paid through the assessee towards finally determined liability and accordingly credit is allowed in determining the sum finally payable/refundable. If, so, the income disclosed through the assessee in the return is accepted through the Assessing Officer without creation any modification therein, and if self-assessment is correctly made there should be no tax payable through or refundable to the assessee.

If he fails to create a self-assessment, the interest for short payment of advance tax at the rate of 2% per month or part thereof in respect of short payment calculated on the foundation of return of income which starts running from 1st April of the assessment year continues to run up to the date of determination of tax. In addition, the assessee creates himself liable for recovery action through the department which can initiate proceedings/for recovery of tax and interest due on self-assessment through any method permissible under the Act including coercive action like attachment and sale of property.

CONSEQUENCES OF DELAY IN FILING RETURN

The following consequences follow:

- The Assessing Officer can, after giving an opportunity to the assessee, complete the assessment ex parte. Ex parte assessment is also recognized as best-judgment assessment because in such case the Assessing Officer creates an estimate of total income to the best of his judgment on the foundation of whatever information is accessible with him. Although best-judgment assessment is the result of an estimate only, the courts have held that such an estimate should be reasonable and not arbitrary or capricious.
- An assessee is liable for interest at the rate of 2% per month or part thereof from the date following the due date up to the date of actual filing of return or if an ex parte assessment has been completed, up to the date of. assessment. This interest is charged on the amount establish payable on the determination of liability either through completion of assessment or issue of intimation and is in addition to the interest chargeable on short payment of advance tax (Refer. 13.5).
- The assessee may even be liable for prosecution on a complaint filed through the Department in the court of competent Magistrate. On the successful completion of the prosecution proceedings, punishment may be awarded in the form of rigorous imprisonment for a term which

wwwwwww. In a case where the tax which would have been evaded exceeds on lakh can be flanked by six months to seven years, and

xxxxxxx. In other cases. can be flanked by three months to three years.

In addition to rigorous imprisonment. Magistrate can also impose fine. Prosecution cannot, though, be launched where the return, though late, was filed within the assessment year or where the tax payable after deduction of TDS and advance tax does not exceed three thousand rupees.

CONSEQUENCES OF INCORRECT INFORMATION

Incorrectness in the return form can be of two kinds. These are discussed as follows:

- ***Prima facie errors :*** Such errors exist where information furnished through the assessee is not incorrect but in computing the total income, sure allowances, deductions or relief have been claimed which are not allowable under the provisions of Income Tax Act, or there is some arithmetical inaccuracy like totaling error etc. For instance, the assessee may without any effort to illustrate personal expenses as business expenses, claim such expenses in computing business income. In such cases he has not made any misrepresentation or wrong statement but has not acted in accordance with the provisions of law in computing his total "income for the purpose of return. Another instance may be claim of deduction for expenses of capital nature. If the nature of such expense has been correctly stated but in computing the income such expense has been deducted, it is not misrepresentation but wrong computation of income. He may buy a car and illustrate the payment as such but if he claims deduction for it, such incorrectness will fall in this category. These are more in the nature of mistake rather than 'concealment' for which law takes a comparatively lenient view.
- ***Concealment:*** Concealment arises where the particulars of income are concealed or inaccurate particulars of income are furnished. This kind

of incorrectness is more serious in nature as there is an effort either to suppress the information which would have resulted in determination of correct income or submit such information which is not correct. For instance, the assessee may earn some commission but may not disclose it at all. Or he earns a commission of Rs. 20,000 but discloses only Rs. 10,000. In the first case he concealed the particulars of income and in the second case he furnished inaccurate particulars of income, Other instances of the incorrectness of this kind are where sales are suppressed, expenses claimed arc either not incurred at all or shown at inflated figure, any income received is either not shown or suppressed or income earned through one is shown to have been earned through another with a view to get tax advantage. These are cases of 'concealment of income' and not mere computation of income in incorrect manner and, so, the law take a more serious view of such lapses. The consequences of the two kinds of inaccuracies arc given below:

yyyyyyy. If the return contains 'prima facie' errors of the nature, the law authorizes the Assessing Officer to correct them 'suo moto' without giving any opportunity to the assessee. Even in cases which arc to be investigated, the Assessing Officer can create adjustments for such errors in the total income and work out tax payable thereon. For instance if A has filed a return showing total income at Rs. 50,000 after claiming average deduction of Rs. 15,000 out of salary income instead of Rs. 12.000 permissible under the Act, the Assessing Officer can correct this mistake on his own, compute total income at Rs. 53,000 after such prima facie adjustment and issue intimation asking him to pay tax on that foundation. In order to ensure that the assessee does not create such errors deliberately to take a chance of not being detected, the law gives for charge of additional tax equal to 20% of the tax relatable to such adjustments. In the instance if tax on Rs. 53,000 is Rs. 8.8110 and tax on Rs. 50,000 is Rs. 7,600 the extra tax on account of adjustment is Rs. 1,200 on which 20%, i.e., Rs. 240 will be charged from the assessee as additional tax.

zzzzzzz. If the particulars of income are establish to have been concealed or inaccurate particulars of income are establish to have been furnished, the Assessing Officer can initiate penalty proceedings for such concealment and after giving the assessee an opportunity of being heard, impose monetary penalty of an amount ranging from 100% of the tax on concealed income to 300% of such tax. For instance, if the. returned income of Rs. 50,000 is finally assessed at Rs. 1,00,000 through creation addition for concealed income, the tax relatable to such additions will be Rs. 27,600 _ 7,600, i.e. Rs. 20,000 and penalty impotable can be any amount flanked by Rs. 20,000 (100% of 20,000) and Rs. 60,000 (300% of 20,000) depending upon the gravity of the action and other relevant circumstances.

In addition to the penalty that can be imposed, the assessee may be liable for prosecution in respect of the offence of willful effort to evade tax on a complaint filed through the Department. If the Magistrate is satisfied that he willfully attempted to evade any tax, penalty or interest under the Income Tax Act, he may punish the assessee:

- With rigorous imprisonment of a term flanked by 6 months and 7 years and with fine where the amount sought to be evaded exceeds one lakh;
- With rigorous imprisonment for a term flanked by three months and 3 years with fine. in other cases.

PROCESSING OF RETURNS

Each return form has two shapes of acknowledgements attached to it. These are not mere acknowledgements but also contain the broad details of income shown in the return and other relevant information in relation to the pre-paid taxes in the form of TDS, advance tax and self-assessment tax. The person who fills in the return should also complete the entries in the acknowledgement form. When the return is submitted at the receipt counter of the income tax office, the receipt clerk signs the acknowledgement shapes put the office seal thereon and hands in excess of one copy of such form to the assessee as acknowledgement of the receipt of return containing information shown in the acknowledgement form.

These return shapes are then processed in the income tax office with a view to discover out whether any tax or interest is payable through or refundable to the assessee on the foundation of information supplied in the return. Such processing results in one of the following situations:

- The pre-paid taxes are correctly computed as a result of which there is neither any tax payable nor any refund is due to the assessee. In this situation, there is no action to be taken through the department. The assessee may stay the acknowledgement form for record and there shall be no proceedings.
- The pre-paid taxes are establish to he more than the tax and interest due. In this situation, a refund of an amount equal to the excess tax paid beside with interest payable through the Government thereon will be made to the assessee.
- The pre-paid taxes are establish to be less than the amount of tax and interest establish due. In this case, a letter will be issued through the Assessing Officer to the assessee intimating the amount of tax and/or interest due and asking him to pay the similar within 80 days of the receipt of the letter. This letter is technically recognized as 'Intimation' and is measured to be a notice of demand issued through the department'. It is dissimilar from an assessment order which is passed only in selected cases after giving him an opportunity to be heard.

While working out the tax and/or interest chargeable, the Assessing Officer can create adjustments in respect of the following:

- Any arithmetical error in the return accounts or documents accompanying it;

- Any loss accepted forward, deduction, allowance or relief which on the foundation of information accessible in such return, account or document is prima facie admissible but which is not claimed
- Any loss accepted forward, deduction, allowance or relief which has been in the return but which is prima facie inadmissible.

These adjustments have came to be recognized as 'prima facie adjustment' which can be made through the Assessing Officer 'suo moto' without giving assessee any opportunity to be heard. There is no appeal against such adjustments but if any adjustment is made not falling within any of the three categories, the Assessing Officer can be requested to rectify the error. If the Assessing Officer refuses to rectify, you can file an appeal against such refusal. As mentioned in there is a charge of additional tax equal to 20% of the tax attributable to such adjustments. It is, so, necessary that only admissible deductions, allowances and relief's are claimed to avoid any enhancement of total income as a result of such adjustments and no chance is taken through creation claims for apparently inadmissible items.

After processing the returns for the purpose of refund/intimation, the Assessing Officer, if he considers that the case is fit to be scrutinized for the purpose of ensuring that assessee has not understated the income or computed excessive loss or under paid tax in any manner, will serve a notice on him asking him, on a date to be specified therein, to-attend his office or produce proof to substantiate the information in the return. The Assessing Officer will after hearing the assessee, considering the proof adduced through him and creation enquiries as he may discover necessary, pass an order, described 'assessment order' determining the total income and the further tax, if any, payable through him beyond the amount establish payable on preliminary processing for issue of refund or intimation. A notice of demand is issued for such further amount payable within 30 days of the services of the similar. The order is appeasable. If the Assessing Officer comes to the conclusion that particulars of income filed ,were willfully inaccurate, he may initiate penalty proceedings for concealment of income.

RE-ASSESSMENT OF INCOME

If the Assessing Officer has cause to consider that any income chargeable to tax has escaped assessment either through cause of assessee's failure to file the return within the permitted time or for any other cause including understatement made through him in the return, he can issue a notice to the assessee asking him to furnish a return of income within the era specified in the notice and then proceed to compute or recomputed the income in the similar manner as specified in 13.7 for processing of original returns. Before any such notice is issued, the Assessing Officer is bound to record reasons as to why he holds the belief in relation to the escapement of income in that case.

If the assessee's case was originally scrutinized (Refer Para 4 of 13.8), the case can be re-opened up to four years only. If four years have expired from the end of relevant assessment year, it can be re-opened only if it can be recognized that the escapement occurred on account of his failure to create a return or on account of his failure to disclose fully and truly all material facts necessary for the assessment of that year. Further, such assessment can be reopened after four years only if the escaped income is likely to exceed Rs. one lakh. For re-opening of assessment beyond four years, the approval of Commissioner is also necessary. No assessment can be reopened after 10 years.

If the assessee's case was not scrutinized earlier, case can be re-opened after four and seven years only if the escaped income is likely to exceed Rs. 25,000 and Rs. 50,000 respectively. Here also no case can be reopened after 10 years.

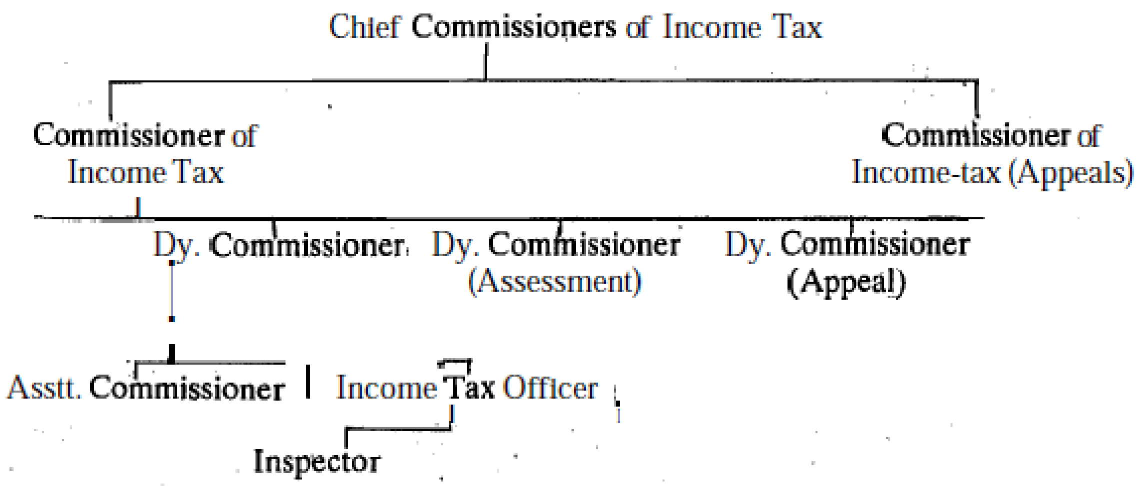
TAX AUTHORITIES

The Central Board of Direct Taxes (CBDT) is the apex body for the administration of direct tax laws. It functions as a part of the Department of Revenue under the Ministry of Finance, Government of India. It has one Chairman and six Members. It assigns jurisdiction to Chief Commissioners of

Income Tax and the Commissioners of Income Tax. The CBDT is assisted through its attached offices, viz., Directorates which function under the overall supervision of Directors-Common. These Directorates are:

- Directorate of Income Tax
- Directorate of Audit
- Directorate of Research, Statistics & Public Dealings
- Directorate of Management Services
- Directorate of Systems
- Directorate of Investigation
- Directorate of Recovery

The CBDT is primarily a policy-creation body. For actual implementation of Income Tax Act, the following chart will illustrate the organisation set up:



Their functions in brief are as follows:

- ***Inspectors:*** They are mainly responsible for outdoor duties in the matter of 'surveys and enquiries for assistance of the assessing officers.
- ***Income Tax Officers:*** Assessing officers are responsible for the work of processing the returns, assessment, collection, recovery and other related matters within the jurisdiction assigned to them,
- ***Deputy Commissioners:*** They supervise and guide the work of Assistant Commissioners/Income Tax officers. Dy. Commissioners

(Assessment) is the Assessing Officer to whom significant, cases are assigned for assessment and other related matters. Dy. Commissioner (Appeal) hears and decides appeal against such orders of Assistant Commissioners and income Tax Officers as the CBDT may decide.

- ***Commissioner of Income Tax :*** They supervise the work of Dy. Commissioners within their charge and statement to the CBDT through their Chief Commissioners They assign jurisdiction to Dy. Commissioners within their charge. They cannot, though, interfere in the discharge of judicial functions through the Dy. Commissioners (Appeal).
- ***Commissioner of Income Tax (Appeals) :*** Appeal jurisdiction in relatively significant cases from revenue angle is assigned to them. Appeal in relatively less significant cases are heard and decided through the Dy. Commissioner (Appeal)
- ***Chief Commissioners of Income Tax:*** They arc row flanked by Commissioners and the CBDT and are responsible for administration and management of the offices within their zones.

REVIEW QUESTIONS

- What are the consequences of delay in filing return?
- What steps are involved in processing a return?
- What are the dissimilar tax authorities and what are their functions?

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