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INSTITUTE OF DISTANCE AND OPEN LEARNING

STUDY MATERIALS

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FINANCIAL MANAGEMENT

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POST GRADUATE DIPLOMA IN FINANCIAL MANAGEMENT (PGDFM)

CORPORATE TAXATION
PAPER 06

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UNIT I

BASIC KNOWLEDGE OF TAXATION

Learning Objectives: At the end of this unit , students will understand the following aspects of business taxation:

- Meaning of tax
- Need for levy of tax
- Levy of income Tax
- Basic Concepts of Income tax law

1.1 Introduction :

A tax is a legal collection by the Government. The Government enjoys its power to levy taxes from constitution of India. The powers of taxation of the Government both the Central and the State Government are regulated through the constitution of India.. Article 265 of our constitution reads as "No tax shall be levied or collected except by authority of Law". Hence a tax is a legal collection. Schedule VII of the constitution contains the matters on which the Central Government and the State Government can make laws. Division of resources between Centre and the State as enumerated in schedule VII under list I, II & III are-

- **Schedule VII (List-1):** It contains the matters in respect of which only the Central Government has the power of legislation like the powers of levy of Taxes on Income in the form of Income Tax , Taxes on services in the form of Service Tax,(Entry 92C of union list) etc. Hence State Government has not power to levy taxes on matters contained in the union list.
- **Schedule VII (List-II):** It contains the matters in respect of which only the State Government has the power of legislation like the power of levy of state value added tax, agricultural Income tax etc.
- **Schedule VII (List-III):** It contains the matters in respect of which both the Central and the State Governments have the power of legislation.

Taxes form a major source of revenue for any Government. In Indian tax system

both Direct and Indirect taxes are levied as a source of Public Revenue to meet various Public expenditures of the Government. The main sources of direct and indirect taxes in India are Income tax, sales taxes, excise duty, custom duty and of late service tax.

For proper and smooth levy and collection of taxes, the Government of India lays down rules governing the levy of taxes. The set of rules so laid down are referred to as an 'Act'. Hence, there are various acts written, each for a specific purpose. The Income tax Act, 1961 is written as the law of Income tax levy in India, The Central sales tax Act 1956 has been written to lay down rules for fixing levy of tax on sale of goods and so on.

1.2 Meaning of Tax :

A tax is a compulsory contribution to the Government for which no direct benefit is generally offered to the tax layer. The bases for levy of taxes are Income, goods and services. Therefore, a tax can be defined as a levy by the government on a product, income or activity. When a tax is levied by the Government on income of a person, the tax is called a direct tax, like income tax etc. but when a tax is levied by the government on goods and services, it is called an Indirect tax like sales tax, service tax, excise duty, custom duty etc.

1.3 Need for levy of tax :

Public expenditures of the Government like expenditures on defence, infrastructures, education, health, internal security etc. are met primarily from revenues derived from levy of taxes both direct and indirect. So Public Revenues like taxes are the means for meeting Governmental expenditures on various Public welfare activities.

1.4 Levy of Income Tax :

Income tax is levied and collected by the central government. Income tax is a direct tax levied on the total income of the previous year of every person at the rate/rates prescribed by the Central Act (Income Tax Act) for the relevant Assessment Year. This basis of charge is fixed by section 4 of the income tax Act 1961.Under Income Tax law the year in which Income is earned is known as 'Previous Year' and the next year in which such income is taxed is known as 'Assessment Year'. For example Income earned in the previous year 2007-08 shall be taxed in the next year known as assessment year 2008-09.

Income tax Act contains 298 sections distributed under XIV Schedules. These undergo changes every year as brought by the Finance Act passed by the Parliament. Finance Bill ,2008 (as passed by the Parliament) shall contain amendments made in Income tax Act,1962.Therefore there are amendments in Income Tax laws every year as brought by the relevant Finance Act . Every year the Finance Minister of the Government of India presents the Union Budget to the Parliament which contains detailed tax proposals, Fiscal Policies of the Government. In order to implement the budget tax proposals, the Finance minister introduces the Finance bill in the Parliament and when the Finance bill

is passed by the Parliament and gets the assent of the President of India, it becomes the Finance Act.

The department of Income tax functions under the direct control and super vision of the Central Board of Direct Taxes (CBDT) under the Ministry of Finance of the Government of India. The CBDT is empoweredto make rules for carrying out the purposes of the act. The rules framed by CBDT from time to time for administration of the Income Tax law are collectively called the Income Tax rules. Thus, Income Tax rules are necessary to be studied along with the Income Tax Act for proper determination of Income tax liability of a person.

Apart from Income tax 1961 act and Income tax rules, 1962, circulars and notification are issued from time to time by CBDT for guidance of the Income tax officers and/or the tax payer. The Income tax department is bound by the circulars and has to follow and implement the circulars/notifications issued by CBDT. But these circulars are not binding on the tax payer i.e. he can use beneficial circulars for determination of his tax liability.

Last but not the least, decisionsgiven by the judiciary on disputed issues between the tax payer and I.T. department are very important source of applicable Income tax laws. As we know the Supreme Court of India is the Apex court of the country and hence the law laid down by Supreme Court becomes the law of the land.On the other hand, the decisions given by various High Courts will apply in the respective states in which such High courts hold jurisdiction. Hence Judicial Pronouncements by various Courts in India are also an important source of Income tax law.

1.5 Basic Concepts of Income Tax Law :

The basis of charge of income tax as laid down in section 4 of the Income Tax Act, 1962 brings out the following main characteristics of Income tax.

(I)Income tax is an annual tax unlike sales tax which is computed on a monthly/quarterly basis.

(II) Income tax is levied on 'total income' of a person. The word 'Income' has been defined in section 2(45) of the I.T. Act. The definition of Income begins with the word "Income includes........." Therefore, the definition of Income given in I.T. Act is an inclusive definition and not and exhaustive one. Such a definition of Income does not restrict the scope of income but leaves enough room for more inclusionswithin the meaning of the term income for levy of tax as per the general and natural meaning of the term income. The inclusive definition of Income as given in section 2(45) includes among others.

(a) Profit and gains

(b) Dividends

(c) Capital gains v/s 45.

(d) Any wining from lotteries.

(III) Income refers to revenue receipts. Capital receipts are normally not included within the scope of Income and are not taxable. But, the Income tax act has specially included certain types of capital receipts within the definition of Income. For example section 2(45) which defines Income includes Capital gains chargeable u/s 45 as Income like profit on sale of land is taxable as 'Capital gains' under the I.T. Act, even though a sale of land is not a revenue receipt.

(IV) For the purpose of determination of total income which is chargeable to tax in accordance with section 4, the receipts must be divided into 5 heeds as defined in section 14 of the Act. As per section 14, income of a person is computed under the following five heads :

(i) Salaries.

(ii) Income from house property.

(iii) Profit gains of business or profession.

(iv) Capital Gains.

(v) Income from other sources. The aggregate income under the above five heads is termed as 'Gross total income'.

(V) Income means net receipts and not the gross receipts. Therefore, from gross receipts expenditure incurred in connection with earning such receipts are normally deducted. The admissible expenditures which can be deducted while computing income under each 'head of income 'as aforesaid is prescribed under the income tax act.

(VI) Income earned in a previous year is chargeable to tax in the immediately next financial year. The previous year begins on 1st April of every year and ends on 31st March of the next year. The income earned during this period of 12 months is offered for tax and assessment to the Income tax department by filing a return of income in the immediately following financial year referred to as the "Assessment year". For instance income of previous year 2007-08 is assessed during 2008-09. Therefore, 2008-09 is called the assessment year for the assessment of income of previous year 2007-08. In short, previous year is the 'income year' and assessment year is the 'Tax year'. Here, it is important to note that in case of a newly setup business or profession or a source of income newly coming into existence, the first previous year will be the period commencing from the date of setting up of business/profession or as the case may be the date on which the source of Income newly comes into existence and ending on the immediately following 31st March. For example if a business is newly setup on 1st July 2007, the first previous year will be a period of 9 months (1-7-07 to 31-3-08) relevant to assessment year 2008-09 (1.4.08-31.3.09) .Further, the rule that income of the previous year is assessable as the income of the immediately following assessment year has certain exceptions. Important exceptions are :

(a) Income of a non resident from shipping business.

(b) Income of persons leaving India either permanently or for a long period of time.

(c) Income of a discontinued business.

(d) Income of bodies formed for short duration.

In the above cases, income of the previous year may be taxed as the income of the assessment year immediately proceeding the normal assessment year. For example X and Y jointly setup a 'food mela' at festival time say on 3.4.2007 and the food mela will run for say 2 months only i.e.(from 3.4.2007-31.5.07). so normally the income shall be taxable in the assessment year 2008-09 being the year immediately succeeding to the previous year 2007-08 (period from 3.4.07-31.5.07) but since the business venture is for a short duration of two months, and is not regularly carriedon; in such a case income tax officer has the power to tax the business income from 'food mela' in the year 2007-08 itself instead of normal Assessment year 2008-09.

(VIII) Income tax is levied on every person. Person as defined v/s 2(31) means an individual, a Hindu undivided family (HUF), a Firm (Partnership firm), a company, a local authority, an association of persons(AOP) or Body of Individuals(BOI) and an artificial juridical person. All these persons are separately assessable for Income tax under the I.T. Act, 1961. The definition of the word person is very important because the computation of income and determination rates of tax depends upon the status of the person i.e. whether the person is an individual or a firm or a company or any other entity as defined in section 2(31) of the I.T. Act. There are different rates of tax for individuals firms, companies etc. For example all Partnership firms irrespective of their Income is taxed at a flat rate of tax @ 30% plus surcharge and Educational cess as applicable. on the other hand an Individual is taxed on Income Slabs and tax rates as prescribed after allowing basic exemption limit which is 110000/-(Rs180000/- for women assesses and Rs. 225000/- for Senior citizens) for Ass. Year 2008-2009.

(IX) Total Income is computed under various heeds of income as defined in section 14 after deducting there from the allowable expenditures /deductions of the respective heeds, adjusting for clubbed income and setting off of losses to arrive at 'Gross total Income and finally allowing there from deductions as prescribed u/s 80 to arrive at Total taxable income. Now on the total income, tax is levied as per the provisions the income tax Act.

(X) Income subject to special tax rate/rates are specified in the Income tax Act itself. For example short term capital gains from shares/securities is chargeable @15% plus surcharge and Education cess by virtue of the provisions of section 111A which specifies this rate.(Rate as applicable for Assessment year 2009-2010)Again Long Term Capital Gain (LTCG) is normally taxed @20% plus surcharge and Education Cess by virtue of the provisions of section112 which specified this rate for LTCG. The remaining income after excluding incomes which are taxed at special rates prescribed in Income tax Act are charged at normal rates given by the relevant Finance Act. For example for the current

assessment year 2008-09, the rates as given by the Finance Act, 2008 shall be applicable. The income tax on 'net income' is calculated in the above manner and is reduced by tax rebates as admissible under Income tax law.

(XI) Sections 5 provide the scope of total income in terms of residential status of the assessee. The residential status of a person has to be determined to ascertain which income shall form part of his total income.

The residential status of an individual based on the duration for which he is present in India may be

(a) A resident and ordinarily resident.

(b) A resident but not ordinarily resident.

(c) A non-resident.

The residential status of a H.U.F Firm, AOP, Companies and local authorities or and artificial juridical person can be either resident or non resident. The taxability of a particular receipt would depend upon not only the nature of income and the place of its accrual or receipt but also upon the assessees residential status. Residential status provisions are contained in section 6.

Hence incidence of tax on any person depends upon his residential status. For example income earned outside India will not be taxable in the hands of a non-resident if income is not received in India but will be taxable in the case of a resident and ordinary resident

(XII) There are certain income which are wholly exempt from income tax e.g. dividend income in the hands of shareholders, agricultural income etc. This income will not form part of gross total income and hence are to be excluded. Also certain incomes are partially exempt from tax like HRA, in case of a salaried employee. So, such partially exempt incomes are excluded to the extent and in the manner specified in the Act. Section 10 enumerates income not included in total income. Such income is known as 'Exempted incomes'. Again section 10A, 10AA, 10B, 10BA deals with exemption in respect of income of industrial units in FTZ, SEZ, 100 % EOU and undertakings engaged in export of certain articles or things. Section 11 to 13 provides exemption in respect of income derived from properly held under trust wholly for charitable or religious purposes Section 13A exempts certain incomes derived by a political party.

Suggested Questions :

1) Explain the meaning of tax?
2) What is the need for levying of tax?
3) Write how division of resources has been done in the Schedule VIII.
4) " Income tax is levied on total income of a person." Explain.
5) Define 'Person' under income tax law. Explain the tax laws applicable to different ' Persons.'

UNIT II
COMPUTING THE TAXABLE INCOME

Learning Objectives : At the end of this unit, students will understand the following aspects regarding computation of taxable income.

- Heads of Income
- Determination of Gross Total Income.
- Total Income.
- Income tax rates.

2.1 Concept of Income:

The concept of income is central to the Income-tax Act as it is the income that is taxed by it. Anything, which can be defined as income is taxable unless specifically exempted from tax. The Government of India lays down rules governing the levy of taxes. The set of rules so laid down are referred to as an 'Act'. The Income tax Act, 1961 came into force on 1st April 1962, which lays down the provisions for determining the "Tax" that a "person" pays on the "Total Income".

Income tax is levied and collected by the Central Government. The department of income tax functions under the direct control and supervision of the Central Board of Direct Taxes [CBDT], which is governed by the Ministry of Finance of the Government of India. The following are the main objectives for levying of Income-tax:

(i) Source of revenues : It is an important source of revenue for the Central Government. It is levied and collected by the Central Government but it is allocated among the State Government and various Union Territories on the basis of the recommendations of the Finance Commission.

(ii) Capacity to pay : Income-tax is an important tool in the hands of the Government in achieving the social goal. It is collected on the principle of 'Capacity to pay'. The persons having high incomes have to pay more income-tax whereas the persons having low income have to pay comparatively less income-tax.

(iii) Source of capital : There is several tax saving schemes. The assessees can save income-tax or reduce their tax –liability by investing their income in the saving schemes

incorporated and introduced by the government for the purpose. By investing his funds these schemes, the assessee saves on one hand and reduces his tax-liability on the other. These savings lead a way towards capital formation in the country.

2.2 Heads of Income :

Income-tax is a tax on all incomes received by, or accruing or arising to, a person during a previous year. For computing the total income, incomes from various sources are computed under five different heads of income. Here it is important to note that if there are two or more sources of income falling under a particular head of income, the income is to be computed separately for each source and then aggregated under that head. The various heads of income as mentioned in Sec.14 are:

(i) Salary including allowances, value of perquisites, profits in lieu of salary and pension.(Sec.15 to 17)

(ii) Income from House Property- whether residential or non residential, let out or self-occupied. (Sec.22 to 27)

(iii) Profits and Gains of Business or Profession.(Sec. 28 to 44 D)

(iv) Capital Gains.(Sec. 45 to 55 A)

(v) Income from other sources including interest on securities and other interest incomes, lotteries crossword puzzles, betting, races including horse races, games, gifts, from unrelated persons exceeding the specified limit.(Sec. 56 to 59)

(I) Principles clarifying the concept of income :

(i) Cash or Kind :

Income may be received in cash or in kind. When in kind valuation is made as per rules prescribed, or in the absence of which valuation is at the market price. For example: Mr X a lawyer receives a car in lieu of services provided by him to his client. In this case the "value of car" will be "income" in the hands of Mr X.

(ii) Basis of Income :

Income is taxed whether actually received or accrued, i.e. sometimes the assessee is liable to pay tax on income which has not actually received but wherein the right to receive has accrued.

(iii) Reimbursement:

Reimbursement of official expenses is not income. Reimbursement of personal expenses is however "income".

For example :

(a) Mr Verma , an employee, received Rs 10,000 from the employer company for expenditure incurred by him on behalf of the company.

This is not considered as "income" in the hands of Mr Verma because money

received for official expenses is not income.

(b) Mr Das, an employee, receives Rs 12,000 as reimbursement of the renovation of his house.

This being a personal expense of Mr Das, reimbursed by the employer, will be "income" in the hands of Mr. Das and will be taxed as a perquisite.

(iv) Tax deducted as Source (TDS) :

If a person receives an amount on which tax has been deducted at source i.e. tax is paid by the payor on behalf of the recipient (payee) the income of the recipient has to be grossed up to include the tax paid amount.

(v) Awards :

Award to a sportsman: In the case of a sportsman, who is a professional, the award received will be in the nature of benefit in exercise of his profession and therefore will be liable to tax.

(vi) Burden to prove as taxable and exempt :

In all cases where a receipt is sought to be taxed, the burden to prove the same as taxable lies with the department. Similarly, where the receipt is in the nature of income, the burden to prove it as exempt under any provision of the Act lies with the assessee.

(II) Determination of Gross Total Income :

It is the aggregate of incomes under various heads of income as aforesaid calculated after set-off of unabsorbed depreciation/losses, carried forward from earlier years. Section 32, 32A, 35 and 70 to 80, provides for set off and carry forward of certain losses/allowances. Important provisions relating to setoff and carry forward shall be covered under chapter 'set off and carry forward of losses' later in the study material.

(III) Total Income :

Total Taxable income is computed after deducting permissible deductions contained in sections 80A to 80U (Chapter VI-A of the ACT) from the Gross Total Income .Here it is necessary to mention that by virtue of provisions of Section 111A and Section112 if the gross total income of an assessee includes short-term capital gains from transfer of equity shares/units of an equity oriented mutual fund subject to Securities Transaction Tax or any long-term capital gains, then no deduction shall be allowed against such capital gains.

Illustration 1: Computation of Taxable Income for Assessment Year 2009-10

Mr. Ram has following incomes for Previous Year 2008-09(Assessment Year. 2009-10):

(a) Gross Salary (as per Form16 salary certificate). Rs. 1,80,000

(b) House property (self-occupied). Nil.

(c) Short-term capital gain on sale of shares (Subject to Securities Transaction Tax)	Rs. 32,000	
(d) Long-term capital gain on sale of shares (Subject to Securities Transaction Tax)	Rs. 61,000	
(e) Other Sources		
(i) Bank interest	Rs.8,000	
(ii) Dividend on shares in companies	Rs. 9,000	
(iii) Interest on Govt. Securities	Rs. 6000	
(iv) Interest on debentures	Rs. 11,000	

Mr. Ram also makes the following investments during the year- Contribution to Recognised Provident Fund Rs. 10,360, Deposit in PPF A/c Rs. 10,000 and Payment of LIC Premium of Rs.5,000. Compute his taxable income and tax payable.

Solution : Computation of Taxable Income

(a) Salary as per Salary Certificate		Rs. 1,80,000
(b) Income from house property		
Self – occupied flat		
Annual value		NIL
(c) Short-term capital gain on sale of shares		Rs 32,000
(d) Long – term capital gain on sale of shares	Rs 61,000	
Less: Exempt u/s 10 (38)	Rs 61,000	Nil
(e) Income from other sources		
[(i) + (ii) + (iii) + (iv)]	Rs 34,000	
Less: Dividend on shares in companies [exempt u/s 10(34)	Rs 9,000	Rs 25000
Gross Total Income		Rs 237000
Deduction u/s 80 C		
Contribution to recognised P.F.	Rs 10,360	
Deposit in P.P.F.	Rs 10,000	
L.I.C. Premium	Rs 5,000	Rs 25,360
Total Income		Rs 211640

Tax payable on short-term capital gain

@15 % on Rs 32,000 (See Note)	Rs 4800
Tax Payable on balance income of	
Rs 1,79,640 (211640- 32,000)	Rs 2964
	Rs 7764
Add : Surcharge (See Note)	Nil
Add: Education Cess @ 2% (See Note)	Rs. 155
Add: Secondary & Higher Education Cess @ 1% (See Note)	Rs 78
Total tax, Surcharge and Education Cess Payable	Rs 7997

Notes :

(i) Short-term capital gains from transfer of equity shares/units of an equity-oriented mutual fund, subjected to Securities Transaction Tax shall be taxable at a flat rate 15% u/s 111A.

(ii) Long-term capital gains from transfer of equity shares/units of an equity-oriented mutual fund , subjected to Securities Transaction Tax, shall be fully exempt u/s 10 (38).

(iii) Dividends by domestic companies subject to additional income tax is exempt u/s 10 (34).

(iv) An individual or a HUF will be allowed a deduction u/s 80 C up to Rs1 lakh with respect to savings in specified schemes like Life Insurance Premium, Contribution to Provident Funds, Purchase of infrastructure bonds, Repayment of principal amount of housing loans, investment in time-deposits (of minimum 5 years) with banks under notified scheme, 5 years Post Office Time Deposits etc.

(v) Surcharge is payable @ 10 % if total income exceeds Rs 10,00,000.So, no Surcharge in above problem since total Income is Rs.211640/- only

(vi) Education Cess @ 2% and Secondary & Higher Education Cess @ 1 % on amount of income-tax and surcharge are also payable.

(IV) Income Tax Rates :

(1) For individuals, HUFs, AOPs, BOIs, etc. Table 1

(2) For Companies. Table 2

(3) Short-term capital gains from transfer of equity shares or units of an equity-oriented mutual fund on or after 1.10.2004 subjected to Securities Transaction Tax (Sec. 111 A) 15%(10%forA.Y.2008-09)

(4) Long-term Capital gains. 20%

(5) Special Tax Rate for specified incomes.(Sec115Ato115BBC)

In case of individuals, HUFs, AOP and BOIs,(including non-residents), surcharge shall be payable @10% if total income exceeds Rs.10,00,000.

Surcharge shall be payable by firms and domestic companies @10% and by foreign companies @2.5%, only if total income exceeds Rs.1 crore

Education Cess @ 2% and Secondary & Higher Education Cess @1% on the amount of income-tax and surcharge are also payable.

Table 1: Rates of Tax for Individual, HUF, A.O.P., B.O.I. for Payment of Tax for Assessment Year 2009-10.

Income Tax

Taxable Income (Rs)	**Resident senior Citizens**	**Resident Women Below 65 years**	**Other individuals, HUF, AOP, BOI, etc.**
Upto 1,50,000	Nil	Nil	Nil
1,50,000 to 1,80,000	Nil	Nil	10%
1,80,000 to 2,25,000	Nil	10%	Rs3,000 + 10%
2,25,001 to 3,00,000	10%	Rs4,500 + 10%	Rs 7,500 + 10%
3,00,001 to 5,00,000	Rs 7,500 + 20%	Rs 12,000 + 20%	Rs 15,000 + 20%
Exceeding 5,00,000	Rs 47,500 + 30%	Rs 52,000 + 30%	Rs 55,000 + 30%

(i) Taxable Income excludes long-term capital gains, which are taxable at specified rates as per section 112, and short-term capital gains taxable at specified rates as per Section 111A.

(ii) Education Cess @2% and Secondary & Higher Education Cess @ 1 % shall be leviable on the amount of income-tax and surcharge.

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Taxable Income (Rs)	**Resident senior Citizens**	**Resident Women Below 65 years**	**Other individuals, HUF, AOP, BOI, etc.**
Upto 1,50,000	Nil	Nil	Nil
1,50,000 to 1,80,000	Nil	Nil	10%
1,80,000 to 2,25,000	Nil	10%	Rs3,000 + 10%
2,25,001 to 3,00,000	10%	Rs4,500 + 10%	Rs 7,500 + 10%
3,00,001 to 5,00,000	Rs 7,500 + 20%	Rs 12,000 + 20%	Rs 15,000 + 20%
Exceeding 5,00,000	Rs 47,500 + 30%	Rs 52,000 + 30%	Rs 55,000 + 30%

(i) Taxable Income excludes long-term capital gains, which are taxable at specified rates as per section 112, and short-term capital gains taxable at specified rates as per Section 111A.

(ii) Education Cess @2% and Secondary & Higher Education Cess @ 1 % shall be leviable on the amount of income-tax and surcharge.

@15 % on Rs 32,000 (See Note)	Rs 4800
Tax Payable on balance income of Rs 1,79,640 (211640- 32,000)	Rs 2964
	Rs 7764
Add : Surcharge (See Note)	Nil
Add: Education Cess @ 2% (See Note)	Rs. 155
Add: Secondary & Higher Education Cess @ 1% (See Note)	Rs 78
Total tax, Surcharge and Education Cess Payable	Rs 7997

Notes :

(i) Short-term capital gains from transfer of equity shares/units of an equity-oriented mutual fund, subjected to Securities Transaction Tax shall be taxable at a flat rate 15% u/s 111A.

(ii) Long-term capital gains from transfer of equity shares/units of an equity-oriented mutual fund , subjected to Securities Transaction Tax, shall be fully exempt u/s 10 (38).

(iii) Dividends by domestic companies subject to additional income tax is exempt u/s 10 (34).

(iv) An individual or a HUF will be allowed a deduction u/s 80 C up to Rs1 lakh with respect to savings in specified schemes like Life Insurance Premium, Contribution to Provident Funds, Purchase of infrastructure bonds, Repayment of principal amount of housing loans, investment in time-deposits (of minimum 5 years) with banks under notified scheme, 5 years Post Office Time Deposits etc.

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(IV) Income Tax Rates :

(1) For individuals, HUFs, AOPs, BOIs, etc. Table 1

(2) For Companies. Table 2

(3) Short-term capital gains from transfer of equity 15%(10%forA.Y.2008-09) shares or units of an equity-oriented mutual fund on or after 1.10.2004 subjected to Securities Transaction Tax (Sec. 111 A)

Table 2: Rates of Tax for Companies for A.Y. 2009-10.

Type of Company		**A.Y. 2009 – 10**
A. Domestic Company		
(whether public or private)		
Long-term Capital Gain		20%
Short –term Capital Gain u/s 111A		15%
Other Incomes		30%
B. Foreign Company		
Long – term Capital Gain		20%
Short-term Capital Gain u/s 111A		15%
Income from royalty or Fees for technical services from Government or an Indian Concern		
-in pursuance of an agreement made after 31.5.2005		10%
Other Incomes		40%

Illustration 2 : What will be the assessment year and what period will be treated as previous year if MR. Dev commences his business on?

(i) 1st January, 2007

(ii) 15th July 2006

and (iii) 22nd October 2006

Solution : In each case, his assessment year will be 2007-08 and the period of previous year will commence from the date commence from the date of commencement of business and will end on 31-3-2007. Therefore the following period will comprise of the previous year in each case :

(i) 1st January, 2007 to 31st March 2007.

(ii) 15th July, 2006 to 31st March, 2007.

(iii) 22nd October, 2006 to 31st March, 2007.

Illustration 3 : Ascertain the previous year for the assessment year 2007-08 in the following cases :

(i) Varun maintains his accounts on the basis of financial year.

(ii) Karan, a lawyer keeps his income and expenditure account on the basis of calendar year.

(iii) Neelu bought a house on 29th July, 2006 and let it out at a monthly rent Rs 8000 per month.

(iv) Puneet joined service in Indian Army on 1st September 2006 at Rs 12,000 per month.

(v) Neha joined as manager in a private company for the firs time on 15th December 2006.

Solution :

(i) From 1-4-2006 to 31-3-2007

(ii) From 1-4-2006 to 31-3-2007.

(iii) From 29-7-2006 to 31-3-2007.

(iv) From 1-9-2006 to 31-3-2007.

(v) From 15-12-2006 to 31-3-2007.

Suggested Question :

1) What is the previous year? What are the exceptions to the rule that income of the previous year is chargeable to tax in the immediately following assessment year?

2) Write short notes on the following:

(a) Assessee

(b) Assessment year

(c) Average rate of income tax

(d) Total income

3) "Every financial year is a previous year as well as an assessment year." Explain.

4) "Income tax is a tax on income and not on receipts." Examine this statement and give the features of income.

5) Write the essential characteristics of the term 'Income'.

6) Ascertain the period of previous year for the assessment year 2007-08 under the following circumstances:

(i) Raj started his profession on Diwali 2006.

(ii) Ashok was appointed as a lecturer in commerce on 13th July 2006.

(iii) Mr. Kishore maintains his accounts on calendar basis.

(iv) Nikhil spent Rs 3, 50,000 on his sister's marriage on 10th March 2007. He could only explain the source of Rs 3,30,000 before the I.T.O. for which previous year, Rs 20,000 would be his deemed income.

UNIT III

SALARY

Learning Objectives : At the end of this unit, students will understand the following aspects of Salary.

- Chargeability.
- Tax treatment of Provident Fund.
- Allowances.
- Receipts exempt from income tax.
- Gratuity.
- Special allowances.
- Perquisites.

3.1Chargeability :

Presence of 'employer-employee' relationship is necessary for tax on income under the head 'Salaries'. In the absence of such employer employee relationship income is taxable under some other head as in the case of partner of a firm, Chartered accountants, Cost Accountants, Advocates LIC agents, commission agents etc. Provisions relating to Computation of Salaries are contained in Chapter IV (Part –A) of the Income tax Act.

'As per Section 15 of the Income Tax Act, Salary' is chargeable to income-tax on due basis or payment basis, whichever is earlier. Any arrears of salary paid in the previous year, if not taxed in earlier previous year, shall be charged to tax in the year of payment. The term 'Salary' includes (i) wages, (ii) annuity or pension, (iii) any gratuity over and above the exemption limit, (iv) any fee, commission, (v) any advance of salary, (vi) amount contributed by the employer towards the recognised provident fund in excess of 12% of salary and interest on balance in R.P.F. in excess of 9.5%, (vii) the value of any perquisites and benefits to the employee provided by the employer, (viii) any amount of profit in lieu of salary, (ix) Payment received by an employee in respect of any period of leave not availed of by him, (x) transferred balance in a R.P.F. to the extent it is taxable under Rule 11(4) of Part A of Fourth Schedule of the Income-tax Act,1961, and (xi) Central Government's account under notified pension scheme u/s 80CCD.Further , Salary paid by a foreign Government to its employees serving in India is taxable under the head 'Salary'.

(i) **Advance Salary :** Advanced Salary is taxable in the year in which it is received. So, it is not included in the income of recipient again when it becomes due.

(ii) Arrears of Salary : is taxable in the year in which it is received, provided it is not been taxed in earlier year/years on due basis.

(iii) Bonus : Bonus is taxable in the year in which it is received.

(iv) Pension : Pension received by the employee is also taxable and is taxed under the head- Salary. However, Pension received by a widow after the death of her husband is taxable under the head income from Other Sources and not treated as Salary income since the recipient is not the Employee.

(v) Profits in lieu of salary :

- Any compensation due to or received by an employee from his employer or former employer at or in connection with the termination of his employment or modification of the terms and conditions relating thereto.
- Any payment(other than 'Receipts Exempt from Tax' under section 10) due to or received by an employee from his employer or former employer or from a provident or other fund to the extent it does not consist of contributions by the assessee or interest on such contributions or any sum/ bonus received under a Kenyan Insurance Policy.
- Any amount whether in lump sum or otherwise, due to or received by an assessee from his employer, either before his joining employment or after cessation of employment.

3.2 Tax Treatment of Provident Fund :

	Statutory	**Recognised**	**Unrecognised**
1. Employer's Contribution	Exempt	Exempt upto 12% of salary. Excess taxable as salary	Exempt
2. Interest credited on Employer's contribution	Exempt	Exempt upto rate of 9.5% p.a.	Exempt
3. Employee's Contribution	Eligible for deduction u/s 80C	Eligible for deduction u/s 80C	Not eligible for deduction u/s 80C
4. Lump sum payment received at the time of retirement or termination of service, etc.	Exempt	Exempt (except when Treated as unrecognised fund from the beginning)	Employer's contribution and thereon taxable as 'salary'. Interest on employee's contribution taxable under other sources.

Note- Public Provident Fund (PPF), contributions up to Rs 70000/- by any assessee salaried and others also are eligible for deduction u/s 80C and interest thereon is fully exempt/s 10

3.3 Allowances :

An allowance is normally taxable under the head salaries since allowances are paid during service by the employer to the employee in presence of a employer employee relationship. It is taxable on due/accrued basis whether it is paid in addition to the salary or in lieu thereof. However, certain allowances have been exempted subject to certain conditions. Section 10 deals with exempted allowances. Dearness Allowance/Additional Dearness Allowance is fully taxable as salaries:

- **City Compensatory Allowance:** CCA is taxable as it is a an allowance granted to met expenses wholly, necessarily and exclusively incurred in the performance of special duties unless such allowance is related to the place of his posting or residence. Certain allowances prescribed under Rule 2BB, granted to the employee either to meet his personal expenses at the place whether the duties of his office of employment are performed by him or at the place where he ordinarily resides, or to compensate him for increased cost of living are also exempt. Certain receipts from employers exempt from income tax are contained in Section 10 of the Act
- **House Rent Allowance:** HRA is exempt up to limits prescribed in section 10 (13A) read with rule 2A However HRA received by an employee residing in his own house or in a house for which no rent is paid by him (e.g. residing with parents) is taxable.
- **Entertainment Allowance:** Entertainment allowance is fully taxable, but a deduction is allowed in certain cases.
- Allowances in the nature of Tiffin Allowance, Meal Allowance, Refreshment Allowance, Dinner Allowance, Health Allowance, Medical Allowance, Telephone Allowance, Holiday Allowance, Education Allowance, and Servant Allowance are fully taxable.
- **Conveyance Allowance:** It is exempt to the extent it is paid and utilised for meeting expenditure on travel for office work.

3.4 Receipts Exempt from Income Tax :

(I) Tax Paid on Perquisites : Any tax paid by the employer, at his option, on any income by way of perquisites, on behalf of an employee, shall be exempt [Sec.10 (10CC)]

(II) Leave Encashment/Leave Salary : Leave Encashment is exempt from income-tax subject to certain conditions contained in section 10 (10AA)

(III) Retrenchment Compensation : Any compensation received by a workman at the time of retrenchment or closure or transfer of undertaking (including change of management resulting in interruption of service or modification in the terms of service) is

exempt from tax subject to limits and in the manner contained in {Sec.10(10B)} Besides, relief can also be claimed in respect of taxable portion of retrenchment compensation u/s 89(1). Refer 'Relief on Salary Paid in Arrears or on Advance, Gratuity, Pension, etc.

(IV) Payment on Voluntary Retirement : Any payment, subject to a maximum of Rs. 5 lakhs, received or receivable by an employee of a public sector company or any other company or any authority established under a Central, State or Provincial Act, or a local authority, or a co-operative society or a University (including an institution declared to be a University or an Indian Institute of Technology or any State Government or the Central Government or a notified institute having importance throughout India or in any State or States or a notified Institute of Management at the time of his voluntary retirement or termination of services in accordance with any scheme or any scheme of voluntary separation in case of a public sector company is exempt from tax. {Sec. 10(10 C)}

(V) Commuted Pension : As per Section 10(10A) any payment in commutation of pension received by Government or semi-government employees, under the Civil Pension (Commutation) Rules, or any other such scheme, is fully exempt. Payment in commutation of pension received by any other employee (i.e. private sector employees) is exempt to the extent it does not exceed-

(a) In case the employee receives any gratuity, the commuted value of 1/3[d] of the pension which he is normally entitled to receive, and

(b) In any other case the commuted value of ½ of such pension.

3.5 Gratuity :

Gratuity is exempt as under: {Sec. 10 (10)}

(a) Death-cum-retirement gratuity received by the employees of Central Govt/State Govt. and local authorities is exempt without any limit.

(b) Gratuity received under the Payment of Gratuity Act, 1972, is exempt to the extent it does not exceed 15 days wages for every completed year of service calculated on last drawn wages, subject to a maximum of Rs. 3, 50,000.

(c) Any other gratuity is exempt to the extent it does not exceed one half month's salary for each year of completed service, calculated on the basis of average salary for ten immediately preceding months, subject to a maximum of Rs. 3, 50,000. The ceiling of Rs. 3.5 lakhs applies to the aggregate of gratuity received from one or more employers in the same or different years.

3.6 Special Allowances :

Section 10 (14) (i) (ii) read with Rule 2BB of income tax rules deals with the Taxability or otherwise of a number of allowances granted to employees during service . Some of such allowances are as under the followings:

(I) Following special allowances or benefits [not being a perquisite as defined u/s

17(2)], specially granted to meet expenses wholly in performance of duties, are exempt to the extent such expenses are actually incurred for that purpose.

(a) Travelling allowances on tour or on transfer, including any sum paid for packing and transportation of personal effects on transfer.

(b) Daily allowances on tour or for the period of journey on transfer.

(c) Conveyance allowance for performance of official duties, provided that free conveyance is not provided by the employer.

(d) Any allowances granted to meet the expenditure incurred on a helper where such helper is engaged for the performance of official duties.

(e) Any allowances granted for encouraging the academic research and training pursuits, in educational and research institution.

(f) Uniform allowance for purchase or maintenance of uniform for wear during the performance of the official duties.

(II) Following allowances granted to any employee to meet his personal expenses or to compensate him for the increased cost of living at the place of his office or employment or where he ordinary resides (not including any allowance granted to an employee to compensate him for performing duties of a special nature relating to his office or employment), are exempt.

Nature of Allowance (1)	Place (2)	Maximum Amount (3)
1. Any Special Compensatory allowance in the nature of [Special Compensatory (HillyAreas)Allowance] or High Altitude Allowances or Uncongenial Climate Allowance or Avalanche Allowanc	I. Specified places of Manipur, Arunachal Pradesh, Sikkim, Uttar Pradesh, Himachal Pradesh and Jammu & Kashmir.	[Rs. 800 p.m]
	II. Siachen area of Jammu & Kashmir.	[Rs. 7,000 p.m]
	III. All Places located at the height Of 1,000 meters or more above the sea level, other than places specified at (I) and (II) above.	[Rs. 300 p.m.]
2.Any Special Compensatory Allowance in the nature of Border Area Allowance or remote Area	I. Specified places in Andaman and Nicobar, Lakshadweep, Himachal Pradesh, Mizoram, J&K,	[Rs. 1300p.m]

Nature of Allowance (1)	Place (2)	Maximum Amount (3)
Allowance or Difficult Area Allowance or Disturbed Area Allowance	U.P. and Sikkim	
	II. Continential Shelf of India and the Exclusive Economic Zone of India.	[Rs. 1,100p.m]
	III. Specified places in Arunachal Pradesh, Nagaland, South Andaman, Mizoram, Tripura, J&K and Himachal Pradesh.	[Rs. 1050p.m]
	IV. Specified places in Mizoram, Tripura,Manipur, Himachal Pradesh, J&K.	[Rs. 750p.m]
	V. Jog Falls in Shimoga District of Kranataka.	[Rs. 300p.m]
	VI. Specified Places in Himachal Pradesh, Assam And Meghalaya	[Rs. 200p.m]
3.Children Education Allowances	Whole of India	[Rs. 100 p.m.] per child for a maximum two children
4. Any allowance granted to an employee to meet the hostel expenditure on his child.	Whole of India	[Rs. 100 p.m.] per child for a. maximum of two children.
5. Transport allowance granted to an employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty.	whole of India	Rs. 800p.m.
6. Transport allowance to an employee, who is blind or ortho-paedically handica--pped with disability of lower extremities to meet his exp-enditure for the purpose of commuting between the place of his residence and the place of his duty.	Whole of India	Rs. 1600p.m.

3.7 Payment from Government Provident Fund :

Any payment from the Government Provident Fund (GPF) or Contributory Provident Fund (CPF) is exempt from tax. [Sec. 10(11)]

3.8 Payment from Recognised Provident Fund :

Any accumulated balance due and becoming payable to an employee from a recognised provident fund is exempt from tax, if –

(i) He has been in continuous service for at least five years; or

(ii) His service has been terminated due to his ill-health or due to contraction or discontinuation of his employer's business or any other cause beyond his control; or

(iii) On cessation of his employment his accumulated balance is transferred to another recognised provident fund.

3.10 Perquisites :

Perquisite is a gain arising out of employment in addition to regular Pay. Value of Perquisites taxable under the Act is determined in accordance with the Valuation Rules prescribed under Rule 3 of Income Tax Rules, 1962. A list of some common perquisites given to employees but taxable in the hands of the employees is -

(i) Value of rent free accommodation provided to the assessee by his employer,

(ii) Value of any accommodation provided to the assessee by his employer, at a concessional rent;

(iii) Value of any amenity or benefit granted free of cost or at a concessional rate to the following categories of employees:

- A director in the employer Company;
- An employee being the beneficial owner of the least 20% of the ordinary shares in the employer company; and
- Any other employee whose income under the head 'Salaries' exclusive of all non-monetary benefits or amenities exceeds Rs 50,000 Some of the perquisites taxable under this category are
- Provision of free or concessional educational facilities,
- Reimbursement of medical Expenditure,
- Expenditure on foreign travel and stay during medical treatment,
- Supply of gas, electricity and water,
- Sale of an asset to the employee at concessional price.(including sale of shares in the employer company)

- Value of any other Fringe benefit or amenity as may be prescribed, excluding fringe benefits subject to Fringe benefit tax in the hands of employer such as Household Servants, Interest free Loans to employees Etc.

3.11 Perquisites not taxable:

The following shall, however, not constitute as perquisite:

(i) Value of medical treatment provided to an employee or his family member in a hospital maintained by his employer.

(ii) Reimbursement of expenditure incurred on medical treatment of an employee or his family member in a Government approved hospital (like CHS or CGHS).

(iii) Premium paid by an employer to keep in effect in insurance on the health of an employee under a scheme approved by the Central Government or the Insurance Regulatory and Development Authority for the purposes of section 36(ib);

(iv) Medical insurance premium paid by an employer for the health of an employee or his family member under a scheme approved by the Central Govt. or the Insurance Regulatory and Development Authority u/s 80D(i.e MEDICLAIM);

(v) Provision of motor car or any other conveyance for personal use by the employee.

(vi) Provision of transport facilities.

(vii) Travelling, stay etc. on a holiday, free meals, recreation/club facilities etc.

Illustration 1: Mr Rohit joins employment with HLL Ltd. As on 01/01/06 on a monthly salary of Rs10,000. The salary is due on the 1st of next month. On 15/05/06 his salary is increased to Rs 15,000. Calculate the taxable salary for the previous year 2006-07 and previous year 2005-06.

Solution :

(i) For previous year 2005-06: Salary due for two months (January & February)- taxable salary for the previous year is Rs 20,000. Salary for the month of March 2006 will become due in April 2006 and shall be taxable in the previous year 2006-07.

(ii) For previous year 2006-07: Salary due is for 12 months (March 06 to February 07)- taxable salary for the previous year is Rs 167, 500. Salary for the month of March 2007 will become due in April 2007 and shall be taxable in the previous year 2007-08.

March 2006	:	Rs 10,000
April 2006	:	Rs 10,000
May 2006	:	Rs 12,500
June 06 to February 07	:	Rs 1, 35,000
		1, 67,500

Illustration 2 : Mr. Joshi provides the following particulars of his salary income for the previous year 2006-07.

		Rs.
(i)	Salary	1, 08,000
(ii)	Bonus paid	12,000
(iii)	Furnished flat provided by the company for which it paid per annum rent	78,000
(iv)	Accommodated provided in hotel for two months for which employer paid rent	30,000
(v)	Furniture at cost	50,000
(vi)	Rent recovered from employee	5,000

Determine gross salary for the assessment 2007-2008

Solution: Computation of gross salary for the Assessment Year 2007-2008

Particulars	Rs	Rs
Salary		1,08,000
Bonus		12,000
Furnished accommodation :		
(a) Flat		
(i) 20% of salary = $1,20,000 \times \frac{20}{100} \times \frac{10}{12}$,or		
(ii) Lease rent = $78,000 \times \frac{10}{12}$ = 65,000		
Whichever is less is to be taken as the value of the flat	20,000	
(iii) Add value of furniture = $50,000 \times \frac{10}{100} \times \frac{10}{12}$	4,167	
	24,167	
(b) Value of hotel accommodation:		
24% of salary = $1,20,000 \times \frac{24}{100} \times \frac{2}{12}$ = 4,800		
(c) Rent paid = 30,000		
Whichever is less is to be taken	4,800	
	28,967	
Less : Rent recovered from employee	5,000	
	23,967	
Gross salary	23,967	
	1,43,967	

Suggested Questions :

1) What do you understand by perquisites? Mention different types of perquisites.

2) Define the term "salary" under Income Tax Act. Explain following points in context of it.

   (a) Employer out of salary by the employer.

   (b) Deduction out of salary by the employer.

3) Section 17(2) of the Income Tax Act arrays a number of benefits arising from employment which are not in the nature of monetary income but they are assessed as a salary income.

   Explain briefly the types of these benefits and conditions under which they are taxed as salary Income.

4) Mr X joins service with the Indian Railways on 01/02/2005. He receives the following emoluments :

Basic Pay	Rs 25,000 p.m.
DA	65% of the Basic Pay (20 % enters)
Commission	Rs 1,500 p.m.

   The Central Government Contributes Rs 2,825 per month to a pension fund of X, referred to U/S 80 CCD. Mr X makes a similar contribution. Calculate the total income of Mr X for the previous year 2006-07.

UNIT IV
PROFIT AND GAINS OF BUSINESS OR PROFESSION

Learning Objectives : At the end of this unit, students will understand the following aspects of profit and gains of Business or profession.

- Meaning of Business and Profession
- Chargeability
- Computation of Income from Profit or Gains of Business or Profession
- Computation of Depreciation Allowance
- Expenditures not deductible
- Set off and Carry Forward of Business Loss

4.1 Meaning of Business and Profession :

Income earned from business or profession is taxed under the head 'Profit and gains from business or profession. While calculating the profit and gains, various expenses are deducted from it. In brief, the Income chargeable to tax is the difference of gross receipts and expenses incurred to earn that Income. Profit and gains of a speculation business should be kept distinct from other business. In other words Income from speculative business like trading in shares should not be mixed with non speculative business income like income from trade in Textiles. 'Business has been defined to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture' {Sec.2 (13)}. The definition is not exhaustive but inclusive and is very wide in scope. Business connotes some real, substantive and systematic or organised course of activity or conduct with a set purpose. 'However, a single and isolated transaction may also constitute 'business', as being an adventure in the nature of trade, provided the transaction bears a clear indication of trade'

'Profession' involves the idea of an occupation requiring either purely intellectual skill like profession of a doctor, Engineer or a Lawyer, or in any manual skill, as in painting, art or surgery, skill controlled by the intellectual skill of the operator. 'Profession' for all purposes includes 'vocation'.

4.2 Chargeability :

As per Section 28 the following incomes shall be chargeable under this head:

(i) Profits and gains of any business or profession carried on by the assessee at any time during previous year.

(ii) Any compensation or other payment due to or received by any person specified in section 28 (ii)

(iii) Income derived by a trade, professional or similar association from specific services performed for its members.

(iv) Profits on sale of a license granted under the Import (control) order,1955 made under the Imports & exports (control) Act ,1947, Cash Assistance received or receivable against exports, and Duty drawback of customers or excise, received or receivable against exports.(Section 28 (i) (ii) (iii)

(v) The value of any benefit or perquisite, whether convertible into money or not, arising from business or in exercise of a profession.

(vi) Any interest, salary, bonus, commission or remuneration due to or received by a partner of a firm from the firm to the extent it is allowed to be deducted from the firm's income. Any interest, salary, etc., which is not allowed to be deducted u/s 40(b), the income of the partners shall be adjusted to the extent of the amount so disallowed. Any interest, salary, etc., which is not allowed to be deducted in the assessment of a firm, in terms of section 185, such amount shall not be taxable u/s 28(v).

(vii) Any sum received or receivable for not carrying out any activity in relation to any business, or not to share any know-how, patent, copyright, trade-mark, licence, franchise etc.

(viii) Any sum (including bonus) received under a Keyman Insurance Policy referred to u/s 10(10D)

4.3: Computation of Income from Profit or Gains of business or profession :

Section 29 states that the income referred to in section 28 shall be computed in accordance with the provisions contained in section 30 to 43 D. Further the provisions of Section 44 to 44 D also to be understood properly as these sections contain certain special provisions in connection with the computation of business income. Allowances and deductions provided under section 30 to 43 D are not exhaustive as it is very difficult for the law maker to mention all allowable expenses incidental to carrying of a particular business or profession.

(I) Expenses expressly allowed as deduction -Following expenses incurred are admissible as deductions while computing income from business or profession

1. Rent, rates, taxes, repairs (not including any expenditure of capital nature) and insurance of buildings. (Section 30)
2. Repairs (not including any expenditure of capital nature) and insurance of

machinery, plant and furniture. (Section 31)

3. Depreciation is allowed on

   (i) Buildings, machinery, plant or furniture, being tangible assets.

   (ii) Know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets, acquired on or after 1.4.1998.

In order to claim depreciation, an assessee has to fulfil the following conditions:

- The asset should be owned by the assessee. Where, however, an assessee carries on business or profession in a building not owned by him but taken on lease ,he is entitled to depreciation in respect of the capital expenditure incurred by him after 31.3.1970 on the construction of any structure or any work relating to the building by way of improvement, extension or even renovation of the building. Depreciation is available even in respect of fractional ownership of an asset
- The asset in respect of which depreciation is claimed must have been used for the purpose of business
- Upto Ass Year 2001-2002 claim of depreciation was optional i.e an assessee may not claim depreciation on assets used for his business but from the Assessment year 2002-2003 ,depreciation under section 32 (2) will be available whether or not the assessee has claimed the deduction for depreciation . In other words Claim of depreciation is mandatory from Assessment Year 2002-2003
- Actual cost of an asset is to be computed as per section 43 (1)

(II) Computation of Depreciation Allowance :

Depreciation is allowed :

(i) On actual cost of assets in case of an undertaking engaged in generation or generation and distribution of power at rate/rates prescribed in Appendix IA of the I.T. rules .However such undertaking has the option to claim depreciation at rates prescribed in Appendix I of the I.T Rules by exercising the option before the due date of filing of I.T Returns. In other words Straight line method of depreciation is allowed to such undertakings.

(ii) Except the above, in all other cases depreciation is allowed on written down value of a block of assets, at rates prescribed in Appendix I of the I.T. Rules.

'Block of assets' means a group of assets falling within a class of assets in respect of which same rate of depreciation is prescribed. The term class of assets refers to:

A : Tangible assets, being Building, Machinery, Plant or Furniture

B : Intangible assets, being know-how, patents, copyrights, trademarks etc.

Block of assets based on above class of assets having same rate of depreciation are

to be prepared for computation of depreciation in each block as per rates given in Appendix I of the I.T Rules.

To ascertain the amount of depreciation we should find out the following:

- Written down value (WDV) of block of assets as per Section 43 (6)
- Rate of Depreciation given in I.T Rules (Appendix I). However rate of depreciation is taken @ 50% of the prescribed rate if the asset is put to use for less than 180 days in the year of acquisition.

  As per Rule of depreciation the product of the aforesaid two is the amount of depreciation. For example if WDV of a block of assets (say machinery , rate of depreciation,15%) is Rs.418500 for the previous year 2007-2008,depreciation will be Rs.62775 (i.e 15% of Rs 418500) for the said previous year and hence the depreciated value of this block on 1.4.2008 will be Rs.355725 (i.e Rs 418500- 62775)

  However, In cases where (a) WDV of a block of assets is reduced to zero though the block is not empty and (b) if the block of assets is empty or ceases to exist on the last day of the previous year (though the WDV is not zero) , there shall not be any depreciation allowance for that previous year i.e the aforesaid rule will not apply.

  An additional depreciation is allowed @ 20% of actual cost of any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article of thing. Where an asset or asset falling within a block of assets, as the case may be, is acquired during the previous year and used for less than 180 days in that previous year, the depreciation allowable in respect of such assets shall be restricted to 50% of the amount allowable.

(III) Treatment of Unabsorbed depreciation :

Unabsorbed depreciation shall be first set off against the profits and gains of any business/profession carried on by the assessee and then against income under any other head, for that assessment year (other than income chargeable under the head Salaries). The balance of unabsorbed depreciation, if any, shall be carried forward to the next assessment years to be set off against the profits and gains from any business/profession by virtue of provisions of section 32 (2) .No time limit is prescribed for carry forward of Unabsorbed depreciation.

1. Expenditure on scientific research related to the business of assessee is deductible in accordance with the provisions of Section 35..
2. Expenditure incurred before 1.4.1998 on acquisition of patent rights or copyrights, used for the business, allowed in 14 equal instalments starting from the year it was incurred. (Section 35 A)

3. Expenditure incurred before 1.4.1998 on acquiring know-how for the business, allowed in 6 equal instalments. Whether the know-how is developed in a laboratory, university or institution, deduction is allowed in 3 equal instalments.(Section 35AB)
4. Any capital expenditure incurred and actually paid by an assessee on the acquisition of any right to operate telecommunication services by obtaining licence will be allowed as a deduction in equal instalments over the period starting from the year in which payment of licence fee is made or the year in which business commences where licence fee has been paid before commencement and ending with the year in which the licence comes to an end.(Section 35ABB)
5. Amortisation of certain preliminary expenses, such as expenditure for preparation of project report, feasibility report market survey, etc., legal charges for drafting and printing charges of memorandum and Articles, registration expenses, public issue expenses, etc. incurred before commencement of business or in connection with extension of an [industrial] undertaking or setting up of an [industrial] unit. Expenditure incurred after 31.3.1998, shall be deducted up to a maximum of 5% of the cost of project or the capital employed, in 5 equal instalments over five successive years. (Section 35 D) Expenditure incurred upto 31.3.1998 would be allowable up to a maximum of 2.5% of the cost of project or the capital employed, in 10equal instalments over ten successive years.
6. One-fifth ($^1/_5$) of expenditure incurred on amalgamation or demerger, by an Indian company shall be deductible in each of five successive years beginning with the year in which amalgamation or demerger takes place. (Section 35 DD)
7. One-fifth ($^1/_5$) of amount paid to an employee in connection with his voluntary retirement under a scheme of voluntary retirement, shall be deductible in each of five successive years beginning with the year in which the amount is paid. (Section 35DDA)
8. Amount of Insurance premium paid for stocks or stores used for business is allowed as deduction (Section 36 (1) (i)
9. Insurance premium paid for the health of employees by any mode other than cash under the scheme framed by G.I.C. and approved by the Central Govt. or by any other insurer and approved by the IRDA. (Section 36 (1) (ib)
10. Payments of bonus or commission to employees, irrespective of the limit under the Payment of Bonus Act provided the same is not payable to him as profit or dividend .The expenditure is allowed on actual payment basis in the year of Payment (Section 36 (1) (ii)

11. Interest paid on capital borrowed for the purpose of business or profession is allowed as a deduction. If interest is paid on borrowing for acquisition of a capital asset ,then interest from the date of borrowing till the date on which such asset is first put to use, shall not be deductible as business expense u/s 36 (1) (iii)
12. Amount of bad debt actually written off as irrecoverable in the accounts not including provision for bad and doubtful debts. (Section 36 (1) (vii)
13. Amount paid by way of Banking Cash Transaction tax during a previous year.
14. Securities transaction tax paid in respect of transactions in securities, income from which is include under the 'business' head for that year.
15. Commodities transaction tax paid in respect of transactions in commodities income from which is include the 'business' head for that year.
16. Entertainment expenditure can be claimed u/s 37(1), in full without any limit restriction, provided the expenditure is not of capital or personal nature.
17. Payment of Remuneration, salary, etc. and interest on capital to partners are allowed as business expenses in the hands of the Partnership Firm in accordance with the provisions of section 40 (b)
    (a) Payment of interest to any partner by a firm, which is authorised by and is in accordance with the terms of partnership deed, subject to a maximum rate of 12% p.a.
    (b) Payment of salary, bonus, commission or remuneration paid by a firm, to a working partner in accordance with the terms of partnership deed, subject to specified limits given in section 40 (b)

(IV) General Deductions (Section 37 (1)) :

Any expenditure (not being expenditure of the nature described in section 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee) expended wholly and exclusively for business purpose or for profession shall be allowed as expenses while computing the income under the head ' Profit or Gains of business or Profession . However the law specifically provides that an expenditure which is incurred for any purpose which is prohibited by law or which is an offence shall not be deemed to be an expense for business purpose and no deduction for such an expense will be allowed in computing the income of business or profession.

Section 37 (1) is a residuary section and hence any expense incurred incidental to carrying of the business or profession shall be allowed as deduction in computing income if the above conditions laid down in the Act in section 37 (1) is satisfied. Therefore, the following expenses shall be allowed without any monetary limit or conditions if incurred in continuance of business although not specifically mentioned in the Act:

- Travelling expenditure
- Entertainment expenditure

Advertisements and Publicity .However the Act has expressly disallowed advertisements in any souvenir, brochure, pamphlet or the like published by a political party. Therefore, normal advertisement expenses shall be allowed without any monetary limit. Here it is important to know that big advertisement expenditures benefiting a business for a number of years in future shall not be allowed in full in one accounting year but such expenses are to be spread over future accounting years also depending on number of years to which the expense will benefit the business.

- Expenditure on presentation articles
- Legal expenses incurred in connection with business. Civil defence expenses are allowed, however legal expenses on criminal prosecutions are held to be not allowable being an expense prohibited by law.
- Professional Tax
- Salaries and wages to staff
- Sales promotion expenses
- Routine business expenses on telephone charges, Printing and stationery, Staff welfare, conveyance etc.

In short, test for allow ability mentioned in section 37 (1) is to be confirmed before claiming an expense as a allowable expense in computing the business income.

4.4 Expenditure Not Deductible :

Section 40,40A and 43 B shall always prevail over any other provisions of this Act in the matter of allow ability of an expense in computing business income.

(I) **Expenses deductible on actual payments only :**Any sum payable by way of tax, duty, cess or fee, by whatever name called, or contribution to provident fund, superannuation fund, gratuity fund or any other fund for the welfare of the employees, or bonus or commission to employees, or interest on loan or borrowing from public financial institutions, or a State financial corporation or a State industrial investment corporation, or interest on loan or advances from a scheduled bank, or amount payable in lieu of leave at the credit of an employee (i.e. leave encashment) shall be allowed as deduction, provided the sum is paid before the due date of filing the return and the proof of payment is furnished along with the return. (Section 43B):

1. Any interest, royalty, fees for technical services or other sums chargeable under this Act, which is payable outside India, or in India to non-resident or a foreign company on which tax has not been deducted or, after deduction, not deposited into the Govt. treasury within the prescribed time. (Section 40 (a) (i))

However, where in respect of any such sum, tax is deducted or paid in any subsequent year, , such sum be deductible in the previous year in which the tax is so paid.

2. Any interest, commission or brokerage, rent, royalty, fees for professional or technical services payable to a resident, or payments to a resident contractor or sub-contractor on which tax has not been deducted or after deduction not deposited:

a. where the tax was deductible and was so deducted during the last month of the of of the previous year	On or before the due date for filing of return
b. in any other case	On or before the last date of the previous year

However, where in respect of any such sum, tax is deducted in any subsequent year, or is deducted during the relevant previous year but paid after the date specified above, such sum be deductible in the previous year in which the tax is deposited.(section 40 (a) (ia))

3. Any sum paid on account of securities transaction tax.
4. Any sum paid on account of fringe benefit tax.
5. Any tax calculated on the basis of profits or gains of the business or profession.
6. Any sum paid on account of weather-tax
7. Any payment of salaries payable outside India or to a non-resident on which tax is not paid or deducted at source.
8. Any payment to a provident fund or other fund established for the benefit of employees of the assessee, unless proper arrangements of TDS on any taxable payment out of such fund, have been made.
9. Any tax actually paid by an employer on any income by way of perquisites, on behalf of an employee.
10. Any payment of salary, bonus, commission or remuneration (by whatever name called) by firm-
    a. to a non-working partner; or
    b. to a working partner, which is not authorised by or is not in accordance with the terms of partnership deed : or
    c. to a working partner, in excess of the specified limits.
11. Any payment of interest to any partner by a firm Which is not authorised by or is not in accordance with the terms of partnership deed or the interest is in excess of the amount calculated @ 12 % p.a

12. Any expenditure in respect of which payment [or aggregate of payments] made to a person [in a day], otherwise than by way of an account payee cheque or an account payee bank draft, exceeds Rs. 20,000, except when payment(s) is/are made under circumstances specified in rule 6DD of I.T Rules (Section 40A (3)). Therefore, all allowable business expenses exceeding Rs. 20000 are to be paid in the mode referred to above to claim such expenses while computing business income, otherwise the valid allowable expenses covered in section 30 to 37 shall not be entitled for claim as deduction in computing the business or profession income by virtue of the overriding provisions of section 40 (A) (3). As for example payment of Advertisements bill of Rs. 50000 in cash to the Advertising Agent is a valid business expense and is allowable u/s 37 (1) but since the payment is made in cash of a sum exceeding 20000, the whole expenditure is disallowed by virtue of section 40 (A) (3) in computing business income and the expenses of Rs 50000 is never claimed in computing business income. This section is very harsh and non compliance of the section shall result in disallowance of expenses which is otherwise valid allowable business expense under the provisions of the Act.
13. Where the assessee incurs any expenditure , in respect of which payment has been made or is to be made to certain **specified persons**, and the assessing officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods , services or facilities for which the payment is made or the legitimate needs of the business or profession or the benefit derived by or accruing to him there from, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction in computing the total income (Section 40A (2) Specified persons are mentioned in the Act in clause (b) of above section 40A (2)
14. Any provision for the payment of gratuity to the employees on their retirement or termination of their service for any reason is not deductible. However any provision for payment of contribution to an approved gratuity fund or payment of gratuity is deductible.

4.5 Special provisions for computing profits and gains of civil contracts U/S 44AD :

In case of an assessee engaged in business of civil construction or supply of labour for civil construction work whose gross receipts do not exceed Rs. 40lakhs, income from the said business will be estimated at the rate of 8% of gross receipts. No deduction under 'Business' head shall be allowed in such circumstances but in case of a firm salary and interest paid to its partners shall be deductible as per section 40(b) after computing the deemed profit u/s 44AD. Further it is provided in section 44AD that if an assessee declares income at a lower rate than 8% he is allowed to do so but in that case he shall be required to maintain the necessary accounts (u/s 44AA) and get the accounts compulsorily audited (u.s 44AB) as discussed later in the chapter.

Similar provisions are contained for Truck owner's u/s 44AE and Retail business u/s 44AF which however are optional to the assessee i.e the assessee may or may not opt for the presumptive scheme contained in the above sections 44AD, 44AE and 44AF.

4.6 Set Off and Carry Forward of Business Loss :

If there is a loss in any business, it can be set off against profits of any other business in the same year. The loss, if any, still remaining can be set off against income under any other head (other than income under the head 'Salaries) in the same year. However, loss in a speculation business can be adjusted only against profit of another speculation business. Losses not adjusted in the same year can be carried forward to subsequent years for set off.

4.7Method of Accounting :

Profit or gains of business or profession shall be computed only on either cash system or mercantile system of accounting regularly followed by the assessee. The tax-payers shall also follow accounting standards as may be notified by the Central Govt. from time to time for various businesses. (Section 145 (1) (2).) The following two Accounting Standards shall have to be followed for Income Tax purposes:

Accounting Standard I relating to disclosure of accounting policies

Accounting Standard II relating to disclosure of prior period and extraordinary items and changes in Accounting Policies

(I) The main features of the above two accounting standards contained in section 145(2) are :

1. All significant accounting policies adopted in the preparation and presentation of financial statements to be disclosed.

2. Any change in an accounting policy having a material effect, its impact and the adjustments resulting there from to be disclosed.

3. Accounting policies should represent a true and fair view of the state of affairs of the business/profession. The considerations for selection and application of accounting policies are prudence, substance over from and materially.

4. If any of the fundamental accounting assumptions retailing to Going Concern, Consistency and Accrual, is not followed, the fact shall be disclosed.

5. Any change in an accounting estimate which has a material effect state of affairs of the business has to be properly disclosed and also to be quantified.

(II) Valuation of opening and closing stock (Section 145A) :

The opening and closing stock shall be valued in accordance with the method of accounting regularly employed by the assessee and adjusted to include the amount of any tax, duty, cess or fee actually paid or incurred by the assessee as on the date of valuation.

4.8 Maintenance of Books of Accounts of business or Profession :

(I) **Specified Professions :** Every person carrying on profession of law, medicine, engineering, architecture, technical consultancy, interior decoration, authorised representative, film artist, Company Secretary or information technology whose gross receipt from such profession exceeds Rs. 1,50,000 in any of the three years immediately preceding the previous year, or likely to exceed Rs. 1,50,000 during the previous year , is required to maintain books of accounts specified in rule 6F of I.T Rules . Rule 6F mentions the following account books:

(i) Cash book

(ii) Journal if the accounts are maintained accounting to the mercantile system of accounting.

(iii) Ledger

(iv) Carbon copies of bills and receipts serially numbered, where sum exceeds Rs. 25

(v) Original bills and receipts in respect of expenditure incurred by the person or, where such bills and receipts are not issued and the expenditure incurred do not exceed Rs. 50, payment vouchers prepared and signed by the person. In case where the cash book is maintained by the person and contains adequate particulars in respect of the expenditure incurred by him he is not required to prepare payment vouchers

(vi) Medical Professionals has to keep a Daily case register in Form No 3C

(vii) Medical Professionals are also required to maintain an inventory as on the first and the last day of the previous year, of the stock of drugs, medicines and other consumable accessories used for the purpose of his medical profession.

Books of account and documents should be kept for at least six years from the end of the relevant assessment year. By the above professionals

(II) Non specified professional and businessmen : Such Persons who are carrying on the business or profession and their income exceeds or likely to exceed Rs. 1,20,000 or the total sales, turnover or gross receipt exceeds or is likely to exceed Rs. 10,00,000 in any one of the three immediately preceding years or during the previous year, as the case may be, are compulsorily required to maintain such account books as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Act CBDT has not prescribed any specific books of accounts or documents for non specified professionals or businessmen Therefore ,such books /documents has to be maintained as will enable the A.O to compute the total income like : (i) Cash Book and Bank Book, (ii) Journal, (iii) Ledgers, (v) Cash memos, (vi) Payment Vouchers, (vii) Any other account books or documents in continuance of their business.

An assessee who is covered under Section 44AD (business of civil construction or

supply of labour for civil construction), Section 44AE (business of plying, leasing or hiring trucks) or Section 44AE (retail trade in any goods or merchandise0 or Section 44BB (business of exploration, etc. of mineral oils) or Section 44BBB (foreign companies engaged in the business of civil construction, etc., or in certain turnkey power projects) and the assessee claims that his income is lower than the deemed income computed under the respective sections, then the assessee is compulsorily required to maintain the aforesaid books of account. Here, it is important to mention that a Company is required u/s 209 of the Company's Act to compulsorily maintain Books of Accounts as prescribed in Company's Act, 1956. But for determination of the Income Tax liability of a company, the Assessing Officer can insist on books /documents which are otherwise not prescribed in company's Act.

A person who do not fall under any of the above categories are advised to maintain at least the main books of account - a cash book and a ledger so as to avoid unnecessary disputes and arbitrary estimates in assessment proceedings u/s 144 by the Assessing officers (A.O 'S). Under section 145 (3) of the I.T Act an A.O has the power to reject the account books which are unreliable ,false ,incomplete or incorrect and may make an assessment in the manner provided in section 144.

The book of account and documents should be kept for at least 6 years from the end of the relevant assessment year.

(III) Compulsory Audit of Accounts :

Every Person – (a) carrying on business shall if his total sales , turnover or gross receipts as the case may be exceeds Rs. 40 lacs in any previous year or (b) carrying on a profession if his gross receipts exceeds Rs. 10lacs in any previous year or (c) carrying on business of civil contractors, truck operators and retail trades declaring their income at an amount less than the amount computed under section 44AD, 44AE, and 44AF, as the case may be, shall also, get their accounts audited under this section.
Persons deriving income under section 44B OR 44BBA are exempted from the purview of compulsory Tax Audit u/s 44AB.

The audit report by a Chartered Accountant u/s 44AB, along with a statement of particulars should in the prescribed from, as under:

Category	Audit Report Form	Statement of of Particulars form
Where accounts have been audited under any other law	3CA	3CD
Where accounts have been audited under I. T. Act	3CB	3CD

Audit of accounts is also necessary for claiming deductions u/s 80-IA, 80-IAB, 80IB, 80IC OR 80-IDfrom business income. The audit should be got completed and the audit report furnished before the due date for filing return, i.e. by the [30^{h} September] of the Assessment Year. Besides, in case the return is filed late, a copy of the audit report and proof of filing it before the due date must be furnished along with the return.

Failure to get the accounts audited or to furnish audit report, in time attracts penalty u/s 271B up to $^{1}/_{2}$% of turnover or gross receipts or Rs. 1, 00,000, whichever is less.

Suggested Questions :

1) There are certain expenditures which are specially disallowed while computing business income in the case of all assesses. Discuss.

2) What are the admissible deductions in computing the taxable income from "Business or profession" head. Discuss?

3) Can the following expenses be claimed as 'due basis'? If so under what circumstances?

   (a) Sales tax

   (b) Contribution by employer to PF

   (c) Bonus or commission to employees.

4) What are the charging provisions u/s 28 under the head "Profits and Gains of Business or Profession."

UNIT V

INCOME FROM HOUSE PROPERTY

Learning Objectives: At the end of this unit, students will understand the following aspects of Income from House Property:

- Chargeability
- Meaning of Owner of House Property
- Determination of Annual Value
- Determination of net asset value
- Annual value of Self-Occupied Property
- Deductions from House Property

5.1 Chargeability :

Any rental income from a residential or commercial property that is owned by a person is liable to be taxed under this head. The income under the head house property is not based upon the actual income from the property but upon the notional income or the Annual value of the property determined as per the provisions of the Act. So the test for taxability is notional income and not the real income from the house property

The annual value of a house property is taxable as income in the hands of the owner of the property. The term House property consists of any building or land appurtenant thereto of which the assessee is the owner. The appurtenant lands may be in the form of a Playground or compound forming part of the building. 'House property' also includes flats, shops, office space, factory sheds, and agricultural land and farm houses.

Where composite rent is received for property as well as services and amenities like furniture and fixtures, water and electricity etc., only the original value of such property is taxable under the head "Income from House Property". Profit arising from services and amenities are chargeable to tax under the head "Profit or Gain from Business and Profession" or "Income from Other Sources" as may be applicable. The following incomes are excluded from the charge of Income tax under this head:i. Annual value of house property used for business purposes.

i. Annual value of house property used for business purposes.

ii. Income of rent received from vacant land.

iii. Income from house property in the immediate vicinity of agricultural land and used as a store house, dwelling house etc. by the cultivators.

5.2 Meaning of Owner of House Property :

Income from house property is taxable in the hands of its legal owner in whose name the property stands. 'Owner' for this purpose means a person who can exercise the rights of the owner not on behalf of the owner but in his own right.[R.B. Jodha Mal Kuthia vs. CIT (1971) 82 ITR 570 (SC).

However, the following incomes from house property shall be deemed to be belonging to assessee even if he may not be the legal owner of the property:

(i) Income from property transferred by an individual without adequate consideration, to his/her spouse (otherwise than in an agreement to live apart), or to a minor child, not being a married daughter.

(ii) Income from an importable estate held by the individual.

(iii) Income from a house or part thereof allotted or leased by the co-operative society, company or association of persons to the member.

(iv) Income from property in possession of a person in part performance of a contact of the nature referred to in Section 53A of Transfer of Property Act

(v) Income from property in which rights acquired by a person under clause (f) of Section 269UA, by way of sale or exchange or under a long lease extending 12 years or more in the aggregate including the term for which the lease may be extended.

5.3 Determination of Annual Value :

Section 23 deals with the computation of annual value for charging income under the head house property.

The annual value of any property is the sum which the property might reasonably be expected to fetch if the property is let from year to year. In determining reasonable rent factors such as actual rent paid by the tenant, tenant's obligation undertaken by the owner, owners' obligations undertaken by the tenant, location of the property, annual rateable value of the property fixed by municipalities, rents of similar properties in the neighbourhood and rent which the property is likely to fetch having regard to demand and supply are to be considered or where the property or any part thereof is let out, the annual value of such property or part shall be the reasonable rent for that property or part or the actual rent received or receivable, whichever is higher. In determining the amount received or receivable, amount of unrealised rent shall not be included The amount

of unrealised rent shall be equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrecoverable.

Where a property (or part thereof) is let-out and was vacant during the whole or any part of the year, and if due to such vacancy the rent received or receivable is less than the reasonable rent for that property (or part) , then its annual value shall be the amount so received or receivable.

5.4 Determination of Net Annual Value (NAV) :

From gross annual value determined as per section 23 , the local taxes such as municipal tax, water and sewage tax, fire tax, and education cess levied by a local authority are deductible while computing the annual value of the year in which such taxes are actually paid by the owner.[Sec.23(1) First Provision]

5.5 Annual Value of Self-Occupied Property :

At present, a preferential treatment is given to one self occupied property which is not let out as under -

Where the property consists of one house or a part of a house in the occupation of the owner for his own residence, and is not actually let during any part of the previous year and no other benefit there from is derived by the owner, the annual value of such a house or a part of the house shall be taken to be nil.[Sec.23(2)(a) and Sec.23(3)]
Where the assessee is the owner of more than one such house used for the purposes of his own residence the annual value in respect of one of such houses which the assessee may specify in this behalf shall be taken to be nil provided the other conditions are satisfied.[Sec.23(4)(a)]
However, annual value of other houses (other than the one specified), shall be calculated as if these were let-out.

Illustration 1: R owns a house property in Delhi. From the particulars given below compute the income from house property for the assessment year 2008-09.

	Rs.
Municipal Value	2,00,000
Fair rent	2,52,000
Standard rent	2,40,000
Actual rent (per month)	23,000
Municipal taxes	20% of municipal value
Municipal taxes paid during the year	50% of tax levied
Expenses on repairs	20,000
Insurance premium	5,000

Solution: Gross annual value shall be higher of the following two:

	Rs	Rs
(a) Expected rent [Municipal value (Rs 2,00,000), Fair rent (2,52,000) whichever is higher, but limited to standard rent (2,40,000)	2,40,000	
(b) Actual rent received/receivable (23,000 X 12)	2,76,000	
Gross annual value		2,76,000
Less: Municipal taxes paid [50% of (2o % of Rs 2,00,000)]		20,000
		2,56,000
Less : Deductions u/s 24		
(c) Statutory deduction @ 30%	76,800	
Income from house property		179200

5.6 Deductions from Income from Property [Sec.24] :

(i) A sum equal to 30% of the net annual value of the property is allowed as deduction in case of house property other than self occupied properties.

(ii) Interest payable in India on borrowed capital, where the property has been acquired, constructed, repaired, renovated or reconstructed with such borrowed capital, is allowable (without any limit) as a deduction (on accrual basis). Furthermore, interest payable for the period prior to the previous year in which such property has been acquired or constructed shall be deducted in five equal annual instalments commencing from the previous year in which the house was acquired or constructed.

But, in case of Self occupied house property a maximum deduction of Rs 30,000 by way of interest on borrowed capital for acquiring, constructing, repairing, renewing or reconstructing the property is available in respect of such properties. In case of self-occupied property acquired or constructed with capital borrowed on or after 1.4.1999 and the acquisition or construction of the house property is made within 3 years from the end of the financial year in which capital was borrowed the maximum deduction for interest shall be Rs 1,50,000.

5.7 Other Important Provisions for computing house property income:

(i) As per section 25B any arrears of rent, which has not been taxed u/s 23, received in a subsequent year, shall be taxable as income from house property in the year of

receipt, after allowing a deduction of 30% of such amount towards repairs and collection charges.

(ii) As per section 26, where house property is owned by two or more persons and their respective shares are definite, such persons shall not, in respect of such property, be assessed as an association of persons, but their share in income from the property will be computed according to Sections 22 to 25 and taxes in their hands respectively.

(iii) Income from subletting of the house property is taxable, under the head 'Income from other sources' and not under this head, as the person, who sublets the property is not its owner but only a tenant.

5.8 Rules for computing House Property Income :

(i) Determine the gross annual value of the property.- Section 22 & 23

(ii) Deduct municipal tax paid by the assessee, during the year to arrive at the net annual value.

(iii) From the net adjusted annual value make permissible deductions under Section 24 for repairs and interest.

(iv) The balance is the income from house property.

Suggested Questions :

1) What is the concept of deemed ownership of the house property for the purpose of computing income from House Property?

2) What is annual value and how is it determined?

3) Define annual value and state the deduction allowed from annual value to arrive at income from house property.

4) Can there be loss under the head house property? Discuss.

UNIT VI
CAPITAL GAINS

Learning Objectives : At the end of this unit, students will understand the following aspects of Capital Gains :

- Basis of Charge
- Definition of Transfer
- Capital Gain
- Types of Capital Gain
- Mode of Computation
- Fair Value consideration in case of Land and/ or Building
- Rates of tax on Capital Gain
- Exempt from Capital Gain tax

6.1Basis of Charge (Sec 45 (1)) :

Any profits or gains arising from the transfer of a capital assets effected during the previous year is chargeable to income-tax under the head 'Capital gains' and shall be deemed to be the income of that previous year in which the transfer takes place unless such capital gains is exempt u/s 54,54B, 54D,54EC,54F ,54G ,54GA . The essential conditions for taxing capital gains are the followings:

(i) There must be a capital asset.

(ii) Such capital asset must have been transferred.

However, section 45 (1) (A) provides that where there is a profit or gain from insurance claim due to damage or destruction of property ,there will be capital gain, although no asset has been transferred in such a case.

Meaning of Capital Asset :

'Capital Asset' means property of any kind held by an assessee including property of his business or profession, but excludes non-capital assets.[Sec.2(14)]

Non capital assets are-

(i) Stock-in-trade, consumable stores or raw materials held for the purpose of business or profession.

(ii) Personal effects viz. wearing apparel, furniture, motor vehicles, etc held for personal use of the assessee or his family. As a result, any gains arising on sale of personal car or any other personal effect is not taxable. Jewellery will not be treated as personal effects, though held for personal use. Jewellery, shall therefore, be capital asset for capital gain tax purpose. Silver utensils are however held to be personal effect

(iii) Agricultural land in India but excluding agricultural land situated within the jurisdiction of a municipality or a cantonment board having population of 10000 or more or agricultural land situated within 8 kilometres from local limits of such municipality or cantonment board

(iv) Special Bearer Bonds, 1991

(v) 6.5% Gold Bonds, 1977 or 7% Gold Bonds, 1980 or National defence Bonds, 1980.

(vi) Gold Deposit Bonds Issued under the Gold Deposit Scheme, 1999.

6.2 Certain Transactions included in definition of Transfer :

As per Section 2(47), 'transfer' includes :

(i) Sale or exchange of the asset.

(ii) Relinquishment of the asset.

(iii) Extinguishment of any rights in the asset.

(iv) Compulsory acquisition of the asset under any law.

(v) Conversion of the asset into stock-in-trade of a business carried on by the owner of the asset.

(vi) Maturity of redemption of a zero coupon bond issued by an infrastructure capital company /fund or a public sector company on or after 1.6.2005 and notified by the Central Government, in respect of which no payment or benefit is received or receivable before maturity/redemption.

(vii) Handing over the possession of an immovable property in part performance of a contract for the transfer of that property.

(viii) Transactions involving transfer of membership of a group housing society, company, etc, which have the effect of transferring or enabling enjoyment of any immovable property or any rights therein?

(ix) Distribution of assets on the dissolution of a firm, body of individuals or associations of persons.

(x) Transfer of a capital asset by a partner or member to the firm or AOP, whether by way of capital contribution or otherwise.

(xi) Transfer under a gift or an irrevocable trust of shares, debentures or warrants allotted by a company directly or indirectly to its employees under Employees' Stock Option Plan or Scheme of the company as per central Government guidelines.

6.3 Certain transactions not included in transfer :

Certain transfers as contained in section 47 are not regarded as transfer for Capital gain tax purpose and so on transfer of such assets capital gain tax is not attracted

Some of the transactions which are not regarded as 'transfer' u/s 47 and are, therefore, exempt from capital gains tax are -

(i) Any transfer on account of total or partial partition of H.U.F. or under gift or will or an irrevocable trust.

(ii) Any transfer of a capital asset (not as stock –in-trade) by a company to its wholly owned subsidiary company or vice-versa provided the transferee company is an Indian company.

(iii) Any transfer of shares in an Indian company by a foreign company to another foreign company in pursuance of scheme of amalgamation between the two foreign companies

(iv) Any transfer of shares in an Indian company, by a demerged foreign company to the resulting foreign company.

(4A) Any transfer of a capital asset by the predecessor co-operative bank to the successor co-operative bank in a business reorganisation.

(4B) Any transfer by a shareholder of shares held in the predecessor bank in consideration of allotment of shares in the successor co-operative bank, in a business reorganisation.

(v) Any transfer of bonds or Global Depository Receipts referred to in Section 115AC made outside India by a non-resident to another non-resident.

(vi) Any transfer of a capital asset by a banking company to banking institution, in a scheme of amalgamation sanctioned and brought into force by the Central Government.

(vii) Any transfer of capital assets under a scheme of demerger to the resulting company which I an Indian company.

(viii) Any transfer of shares in the amalgamating company in consideration of allotment of shares in the amalgamated Indian company.

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

(x) Any transfer of works of art, archaeological, scientific or art collection books,

manuscript, drawings, etc to the Government, a University, National Museum, etc to the Gallery, National Archives or any other notified museum or institution.

(xi) Any conversion of bonds or debentures, debenture stock or deposit certificates, of a company into shares or debentures of that company.

(xii) Transfer of securities under the stock lending scheme approved by SEBI or RBI.

(xiii) Transfer of a capital asset in a reverse mortgage transaction under the notified scheme.

6.4 Capital Gain – Year of Taxability :

Capital gains form part of the taxable income of the previous year in which the transfer giving rise to the gains takes place. Thus, the capital gain shall be chargeable in the year in which the sale, exchange, relinquishment, etc, takes place. Where the transfer is by way of allowing possession of an immovable property in part performance of an agreement to sell, capital gain shall be deemed to have arisen in the year in which such possession is handed over. If the transferee already holds the possession of the property under sale, before entering into the agreement to sell, the year of taxability of capital gains is the year in which the agreement is entered into.

In case of destruction or damage of a capital asset in fire, flood, riot etc, and receipt of any money or asset as insurance claim, the capital gain shall be chargeable to tax in the year such money or asset is received[Sec.45(1A)].

In case of transfer by way of conversion of a capital asset into stock-in-trade of a business, the capital gains are deemed to arise in the year in which such stock-in-trade is sold or otherwise transferred[Sec.45(2)].

In cases of compulsory acquisition of a capital asset, the amount of compensation or consideration or any part thereof, originally awarded is charged to tax in the year it is received. Any additional compensation shall be taxable in the year of its receipt. Where the amount of consideration/compensation or the enhanced consideration/compensation is subsequently reduced by any court order, the capital gain shall be recomputed with reference to such reduced consideration/compensation[Sec.45(5)].

6.5Types of Capital Gains :

Based on the period of holding of a capital asset prior to its transfer, a capital asset may be a short term capital asset or a long term capital asset and accordingly gains arising on transfer of a capital asset may be a short term or a long term capital gain

(i) **Short Term:** Gains on transfer of capital assets held by the assessee for not more than 36 months [12 months in case of a share held in a company or any other security listed in a recognised stock exchange in India, or a unit of the UTI or mutual fund specified u/s 10(23D) or a zero coupon bond] immediately preceding the date of its transfer.

(ii) **Long Term:** The capital gains on transfer of capital assets held by the assessee for more than 36 months [12 months in case of shares held in a company or any other listed security or a unit of the UTI or of a specified mutual fund or a zero coupon bond.]

Here it is important to understand the meaning of the term period of holding - Period of holding a capital asset is the duration from the date of its acquisition to the date of its transfer. However, the period of holding shall exclude or include certain other periods in cases and under circumstances given in section 49.

(i) In case of a capital asset that becomes the property of the assessee in the circumstances mentioned u/s 49(1), the period for which the asset was held by the previous owner shall be included for ascertaining the nature of capital gain– short term or long term

(ii) In case of a share or any other security, subscribed to under a rights issue, the period shall be reckoned from the date of its allotment.

(iii) In case of a capital asset, being the right to subscribe to a share or any other security, which is renounced in favour of any other person, the period shall be reckoned from the date such right is offered by the issuing company.

(iv) In case of security or sweat equity shares allotted or transferred by the employer free of cost or at concessional rate to his employees(including former employees), popularly called as Employees Stock Option Plan (ESOP), the period shall be reckoned from the date of their allotment or transfer.

6.6 Mode of Computation (Sec 48) :

(i) Ascertain the full value of consideration received or accruing as a result of the transfer.

(ii) Deduct from the full value of consideration-

- Transfer expenditure like brokerage, legal expenses, etc.
- Cost of acquisition of the capital asset/indexed cost of acquisition in case of long-term capital asset, and
- Cost of improvement to the capital asset/'indexed' cost of improvement in case of long-term capital asset.

(iii) The balance left-over is the gross capital gain/loss.

(vi) Deduct the amount of permissible exemptions u/ss 54, 54B, 54D, 54EC, 54 G, 54GA and 54H, etc.

(v) The balance is the net capital gain/loss, chargeable to tax.

6.6.1 Fair Value of Consideration in case of Land and / or Building:

Where the full value of consideration declared in respect of transfer of any land

and / or building, held as a capital asset and not as stock – in -trade, is less than the value adopted or assessed by the State stamp valuation authority in respect of such transfer, the value so adopted or assessed shall be deemed to be the full value of consideration, and capital gains computed accordingly.

Where the assessee claims that the value adopted or assessed for stamp duty purposes exceeds the fair market value, and he has not disputed the same in any appeal or revision or reference before any court, the Assessing Officer may refer the valuation of the relevant asset to Valuation officer. Then the Assessing officer shall take the value determined by the Valuation officer or the value adopted for stamp duty purposes, whichever is less [Sec.50C].

6.6.2Transfer Expenses :

Transfer expenses include brokerage paid for arranging the deal, legal expenses incurred for preparing conveyance deed and other documents, cost of inserting advertisement in newspapers for sale of the asset and commission paid to auctioneer. It is necessary that the expenditure should have been incurred wholly and exclusively in connection with the transfer.

6.6.3 Cost of Acquisition :

Cost of acquisition is the amount for which the capital asset was originally purchased by the assessee [Sec.55(2)(b)]. Cost of acquisition of an asset is the sum total of amount spent for acquiring the asset .Where the asset is purchased, the cost of exchange for another asset, the cost of acquisition is the fair market value of that other asset as on the date of exchange.

Any expenditure incurred in connection with such purchase, exchange or other transaction e.g. brokerage paid, registration charges and legal expenses, is added to price or value of consideration for the acquisition of the asset. Interest paid on moneys borrowed for purchasing the asset is also part of its cost of acquisition.

Where capital asset became the property of the assessee before 1.4.1981, he has an option to adopt the fair market value of the asset as on 1.4.1981, as its cost of acquisition.

6.6.4Cost of acquisition of Previous Owner :

Where the asset was not originally purchased by the assessee but it passed on to him under any of the circumstances mentioned in section 49, the cost of acquisition in the hands of the assessee shall be the cost for which the previous owner acquired it like in case of -

(i) Distribution of assets on total or partition of an H.U.F.

(ii) Transfer under a gift or will or by succession, inheritance or devolution.

(iii) Under a transfer to a revocable or an irrevocable trust.

(iv) Under a transfer referred to in Section 47(iv),(v), (vi), (via), (vica), (vicb) or (viia).

6.6.5Cost of Improvement :

Cost of improvement means all capital expenditure incurred in making additions or alterations to the capital asset, by the assessee(or the previous owner).Betterment charges levied by municipal authorities also constitute cost of improvement. However, only the capital expenditure incurred on or after 1.4.1981, is to be considered and that incurred before 1.4.1981 is to be ignored.

6.6.6 Indexed Cost of Acquisition/Improvement :

For computing long-term capital gains, 'Indexed Cost of Acquisition' and 'Indexed Cost of Improvement' are required to be deducted from the full value of consideration of a capital asset. Both these costs are thus required to be indexed with respect to the Cost Inflation Index pertaining to the year of transfer. In case of bond and debentures, except capital indexed bonds issued by the Government, the cost of acquisition and cost of improvement shall not be indexed.

Accordingly, 'Indexed cost of Acquisition' and 'Indexed Cost of Improvement' shall be computed as under :

Indexed cost of Acquisition

$$= \frac{\text{Cost of Acquisition X Cost Inflation Index for the year of transfer}}{\text{Cost Inflation Index for the year of acquisition or 1981, whichever is later}}$$

Indexed cost of Improvement

$$= \frac{\text{Cost of Improvement X Cost Inflation Index for the year of transfer}}{\text{Cost Inflation Index for the year of Improvement}}$$

It may further be noted that where additions/alterations to a capital asset had taken place over a number of years, then indexed cost of improvement, for each year in which there was an addition/alteration, shall be worked out separately and then aggregated to arrive at the 'Total Indexed Cost of Improvement', in respect of that asset.

6.6.7 Cost Inflation Index :

The Government has notified the following Cost Inflation Index :

S.No.	Financial Year	C.I.I	S.No.	Financial Year	C.I.I
1	1981-82	100	15	1995-96	281
2	1982-83	109	16	1996-97	305
3	1983-84	116	17	1997-98	331

S.No.	Financial Year	C.I.I	S.No.	Financial Year	C.I.I
4	1984-85	125	18	1998-99	351
5	1985-86	133	19	1999-2000	389
6	1986-87	140	20	2000-2001	406
7	1987-88	150	21	2001-2002	426
8	1988-89	161	22	2002-2003	447
9	1989-90	172	23	2003-2004	463
10	1990-91	182	24	2004-2005	480
11	1991-92	199	25	2005-2006	497
12	1992-93	223	26	2006-2007	519
13	1993-94	244	27	2007-08	551
14	1994-95	259			

6.7 Rates of Tax on Capital Gains :

Section 111A deals with tax calculation on short term capital gains. The main provisions are Short term Capital Gains are included in the gross total income of the assessee and after allowing permissible deductions, the total income is subject to tax at the rates in force for the relevant Assessment year. However, short –term capital gains from transfer of equity shares/units of an equity-oriented mutual fund, subjected to Securities Transaction Tax, shall be taxable at a flat rate of 15% [10% for A.Y. 2008-08]. Also, deductions shall not be allowable against such short-term capital gains. Section 112 deals with tax calculations on long term capital gains-

Long term Capital Gains are subject to a flat rate of tax @ 20% .However, in respect of long-term capital gains arising from transfer of listed securities, units of mutual funds / UTI, or zero coupon bonds, tax shall be payable @ 20 % of capital gain computed after allowing indexation benefit or @ 10% of the capital gain computed without giving the benefit of indexation, whichever is less.

6.8 Basic Exemption Available against Short-term Capital Gains from shares etc :

In the case of a resident individual or a resident Hindu undivided family, the basic exemption limit of Rs 1,50,000 [Rs 1,10,000 for A.Y. 2008-09] (Rs 1,80,000 [Rs 1,45,000 for A.Y. 2008-09] for women assesses below 65 years and Rs 2,25,000 [Rs 1,95,000 for A.Y. 2008-08] for senior citizens shall be allowed against total income as reduced by the amount of short-term capital gains, and the balance , if any , shall be allowed against

such short-term capital gains. That is, where the total income as reduced by the short-term capital gains is below the exemption limit then the amount of short-term capital gains chargeable to tax shall be reduced by the amount by which the total income so reduced falls short of the exemption limit.

6.9.1Basic Exemption Available against Long-term Capital Gains taxable at flat rate :

In the case of a resident individual or a resident Hindu undivided family, the basic exemption limit of Rs 1,50,000[Rs 1,0,000 for A.Y.2008-09] (Rs 1,80,000{Rs 1,45,000 for A.Y. 2008-09] for women assessees below 65 years and Rs 2,25,000 [Rs 1,95,000 for A.Y. 2008-09] for senior citizens shall first be allowed against total income as reduced by the amount of long-term capital gains, and the balance, if any, shall be allowed against such long-term capital gains. That is, where the total income as reduced by the long-term capital gains. That is, where the total income as reduced by the long-term capital gains, is below the exemption limit then the amount of long term capital gains chargeable to tax shall be reduced by the amount by which the total income so reduced falls short of the exemption limit.

6.9.2Exemptions of LTCG on sale of equity shares /units of an equity oriented Fund [Section 10(38)] :

Long term capital gains from equity shares or units of an equity-oriented mutual fund, transferred on or after 1.10.2004 and chargeable to Securities Transaction Tax, shall be fully exempt.

6.9.3 Provisions for Set off and Carry Forward of Capital Loss :

(i) If there is loss under any head it can be set be off against income from long-term capital gain and the balance of long –term capital gain , if any , shall be subject to tax @ 20%. For example, if there is a business loss of Rs50,000 and there is long-term capital gain of Rs 90,000, then after setting off loss of Rs 50,000 against long-term capital gain only Rs 40,000 will remain under the head 'Capital Gains' to be included in the total income.

(ii) Any short-term capital loss can be set off against any capital gain (both long-term and short-term) and against no other income. Any long-term capital loss can be set off only against long-term capital gain and against no other income.[Sec.70 and 71(3)].Any short-term capital loss can be carried forward to the next eight assessment years and set off against 'capital gains'(short term or long term) in those years. Any long-term capital loss can be carried forward to the next eight assessment years and set off only against long-term capital gain in those years.

6.10 Exemptions from capital gains tax :

Section 54, 54B, 54D, 54EC, 54F, 54G, 54H Grants exemption of capital gains The main provisions in this regard are -

(i) Any long-term capital gains arising on the transfer of a residential house (including self-occupied house), to an individual or HUF, will be exempt from tax if the assessee has within a period of one year before or two years after the date of such transfer purchased or within a period of three years constructed , a residential house. The exemption is available in the manner and to the extent specified in section 54 of the I.T Act.

(ii) Any long-term capital gain (arising on transfers that take place on or after 1.4.2000) shall be exempt in accordance with the provisions of section 54EC if the whole of the amount of such capital gain is invested in long-term specified assets i.e. bonds issued by National Highway Authority of India (NHAI) or by the Rural Electrification Corporation Ltd, within a period of six months from the date of transfer w.e.f 1.4.2007, the amount of investment in long-term specified assets by an assessee during a financial year, shall not exceed Rs 50 lakhs.

(iii) Any long-term capital gain arising to an individual or an HUF, from the transfer of any asset, other than a residential house, shall be exempt in accordance with the provisions of section 54F if the whole of the net consideration is utilised within a period of one year before or two years after the date of transfer for purchase, or within 3 years in construction, of a residential house.

If, however, only part of net consideration is so utilized, the amount of exemption shall be equal to :

$$\frac{\text{Capital Gains X Cost of New Residential House}}{\text{Amount of Net Consideration}}$$

6.11.1Capital Gains on Self generated assets :

(i) Capital gains arising from the transfer of goodwill are taxable. It may be noted that transfer of goodwill by a partner to the firm or by a member to the AOP/BOI or vice versa, is also taxable. For this purpose, cost of acquisition of self-generated goodwill is nil and that of goodwill purchased from another person is the price paid to that person.

(ii) In computing the capital gain arising on transfer of a trade mark or brand name associate with a business, its cost of acquisition shall be deemed to be nil where it is self-generated, or the price paid for its acquisition where it is acquired from a previous owner

(iii) In computing the capital gains arising on transfer of right to manufacture, produce or process any article or thing or right to carry on any business, the cost of acquisition of such asset, where it had been purchased from a previous owner, shall be purchase price paid, and in other case (i.e. where the asset is self-generated it shall be nil.

6.11.2Capital Gains on Transfer of Depreciable Assets :

Section 50 deals with manner of computation of capital gains on depreciable assets. The important provisions are -

Depreciable assets used in the business are also capital assets and, therefore,

transfer of any such asset would attract capital gain. Important points on capital gains on depreciable assets are:

(i) Capital gain/loss on transfer of a depreciable asset is always 'short-term' irrespective of the period of holding.

(ii) For computation of capital gain, the cost of acquisition/improvement of the asset need not be ascertained. The capital gain is computed with reference to the written down value of the entire block of assets to which the asset under transfer pertains.

Illustration1:

Mr.A purchased a plot of land during 1979-80 for Rs 8 lakhs. He incurred fencing expenses Rs 50,000 during 1980-81. He constructed a residential house on the plot at a cost of Rs 3, 22,000 during 1989-90 and another Rs 2 lakhs during 1992-93. The fair market value of the plot as on 1.4.1981 is estimated at Rs 10 lakhs.

Mr. X sells the house during 2007-08 for Rs 75 lakhs, incurring transfer expenses of Rs 75,000. Compute the taxable capital gains for A.Y. 2008-09.

Solution: Computation of Long-Term Capital Gains

Full value of consideration for the house	Rs	Rs 75,00,000
Less: Transfer Expenses		75,000
Net consideration		74,25,000
Less: Indexed cost of acquisition (See note 1)	55,10,000	
Less:Indexed cost of Improvement (See note 4)	15,25,693	70,35,693
Taxable Long-term Capital Gains		3,89,307

Notes :

(1) Indexed Cost of Acquisition of House is

$$\frac{\text{Cost of Acquisition (See note 2)X CII for the year of transfer(i.e 2007-08)}}{\text{CII for the year 1981-82 (i.e.100) (See note 3)}}$$

$$= \frac{\text{Rs } 10,00,000 \times 551}{100} = \text{Rs } 55,10,000$$

(2) Where the capital asset was purchased before 1.4.1981 and its Fair Market Value

(FMV) as on 1.4.1981 is higher than the actual cost of acquisition, the Cost of Acquisition may be deemed to be the F.M.V. as on 1.4.1981 i.e. Rs 10 lakhs .

(3) The Cost Inflation Index shall be taken for the year in which the asset was acquired by the assessee or for 1981-82 , whichever is later.

(4) (a)Indexed Cost of Improvement (1980-81) = Nil (See note 5)

(b) Indexed Cost of Improvement (1989-90)

$$\frac{\text{Cost of Improvement (1989-90) X CII for the year of transfer (i.e 2007-08)}}{\text{CII for the year in which the improvement took place (i.e. 1989-90)}}$$

$$= \frac{\text{Rs } 3,22,000 \text{ X } 551}{172} = \text{Rs } 10,31,523$$

(c) Indexed Cost of Improvement (1992-93)

$$\frac{\text{Cost of Improvement (1992-93) X CII for the year of transfer (i.e 2007-08)}}{\text{CII for the year in which the improvement took place (i.e. 1992-93)}}$$

$$= \frac{\text{Rs } 2,00,000 \text{ X } 551}{223} = \text{Rs } 4,94,170$$

Total Indexed Cost of Improvement = [(a) + (b) =(c)] = Rs 15,25,693

(5) The cost of improvement incurred before 1.4.1981 shall be ignored and only that incurred on or after 1.4.1981 shall be taken into consideration.

Suggested Question :

1) What are the incomes included under the head 'Capital gains'? Discuss the deductions allowable under this head.

2) What is 'Cost of acquisition' of a capital asset? How is the cost of acquisition determined under different conditions?

3) Discuss the exemptions regarding capital gains.

4) What are to be deducted u/s 48 from the full value of the consideration to compute chargeable capital gains?

5) Mr. X transfers jewellery on 01/11/06. The full value consideration of jewellery transferred was Rs 10.50 lakhs and the expenses on transfer amount to Rs 50,000. His indexed cost of acquisition is Rs 3 lakhs. He purchases a residential house on 15/06/07 for Rs 8 lakhs. Compute the amount of exemption u/s 54F.

UNIT VII
INCOME FROM OTHER SOURCES
AND
SET OFF AND CARRY FORWARD OF LOSSES

Learning Objectives: At the end of this unit, students will understand the following aspects of Income from other sources and Set off and Carry Forward of losses.

- Income from other sources
- Chargeability
- Deductions Allowable
- Meaning of set off and Carry Forward of Losses

7.1 Income from other sources :

Income from other sources is the fifth and last head amongst the five heads of income. Section 56 to 59 of the Income Tax Act 1961 deal with this head. As per section 56(1) any income which falls within the meaning of the definition of income u/s 2(24) but does not specifically fall under the other four heads namely –salary, house property, business and profession or capital gains, then such income shall be taxable under the head income from "other sources". Hence, income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income tax under the head "Income from other sources." If it is not chargeable to income tax under any of the heads specified in section 14, item A to E. In other words, following conditions must be specified before an income can be taxed under the head "Income from other sources."

(i) There must be an income.

(ii) Such income is not exempt under provisions of this Act.

(iii) Such income is not chargeable to tax under any of the first four heads.

7.2 Chargeability :

Incomes chargeable to tax under this head may be divided under two sub-heads: "specific incomes" and "other incomes". The followings are "specific incomes" to be taxable under this head :

(I) Dividends : A share of profit received by a shareholder out of the profits of the

company, proportionate to his shareholding is termed as "dividends." But the legislature in defining dividend has added certain other receipts which otherwise may not have been called dividends. According to Sec.2(22) of the Income-tax Act, receipts which are deemed to be dividends are described as following:

- Distribution of accumulated profits, entailing the release of company assets.
- Distribution can be physical or constructive.
- Renunciation of Rights shares, covered by accumulated profits.
- Shares distributed as dividend must be valued at Market Value.
- Distribution of Bonus Share to Preference Shareholders.

(II) Any Winnings : This includes winning lotteries, crossword puzzles, races, including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.

(III) Income from Letting of Machinery, Plant or Furniture : Machinery, plant or furniture are commercial assets. Any lease thereof is to be regarded as a business transaction, yielding a business income.

(IV) Income under Inseparable Letting of Plant and Machinery along with Building : The income from letting of a building is chargeable to tax under the head "income from house property." But where machinery, plant or furniture belonging to the assessee is let along with building and letting of building is inseparable from the letting of the said machinery, plant or furniture, the rental income from such letting may be chargeable to tax under "other sources."

(V) Interest on Securities [Sec 56(2) (id)]: It means interest: (i) Interest on any security of Central or State Government, (ii) Interest on debentures, (iii) Interest on other security for money, issued by Local authority, company or a corporation established by a central, state or provincial act. Interest on securities becomes due on dates specified on the securities and not at any periodic intervals and also depends on the holding period by the assessee.

(VI) Income from the activity of owning and maintaining race horses :where an assessee maintains horses for the purpose of running them in races, then the income from such race animals from running in races, will be taxable in the hands of the assessee under the head income from "Other Sources."

(VII) Personal Gifts : Any gift of money, exceeding Rs 50,000 in the aggregate, received from unrelated on or after April1, 2006 will be taxable under the head "income from other sources." Only gift of money is subject to tax. Gift in kind is not taxable.

Gift of money received is not taxable in the following cases :

(i) Gift of money received by an individual from any relative;

(ii) Gift of money received on the occasion of the marriage of the individual;

(iii) Gift of money received under a will or by inheritance;

(iv) Gift of money received in contemplation of death of the donor;

(v) Gift of money received from any fund or university or other educational institution.

The following are other incomes not specifically chargeable under other sources:

- Director's fees and director's commission for underwriting shares of a new company.
- Income derived by sub-letting a house by a tenant.
- The salaries of a Member of Parliament.
- Examiners fee received by a lecturer from a university.
- Interest on loans, bank deposit or current account, and interest payable under a decree.
- Interest received on excess payment of advance tax (under Sec. 234B) or interest received on delayed refunds (u/s 243 and 244).
- Interest under National Deposit Scheme is taxable (u/s 56) in the year of accrual.

7.3Deductions allowable (Section 57) :

(I) In case of income from the hiring of machine, plant and furniture along with the buildings-

- Amount spent on the current repairs of the building.
- Premium of the insurance against risk of damages and destruction of the premises.
- Depreciation allowable according to Income Tax rules.

(II) In case of income from family pension, a deduction of 331/3% of such or Rs 15,000 whichever is less.

(III) Any other expenditure lay out or expended wholly and exclusively for making or earning such income.

(IV) Any allowance or expense in connection with income from horse races , spent in the activity of owning and maintaining such horses.

Also, section 58 specifies certain expenses not allowable in computing the income under the head -Income from other sources

7.4 Method of Accounting :

Income chargeable under this head depends upon the method of accounting regularly employed by the assessee. Thus if the

(i) Books are kept on mercantile system or if the books are not kept by the assessee, then the income is taxed on due basis and expenditure is deducted also on due basis.

(ii) If the books are kept on cash system then the income is taxed on receipt basis and

the expenditure incurred is also allowed as a deduction on cash basis.

Illustration 1 :

Mrs. Verma submits the following particulars of her investments. Determine her income from interest on securities for the assessment year 2007-08.

(i) Rs 78,000 , 9% less tax non-listed debentures of ACC Ltd.

(ii) Rs 89,000, 12 % securities of Punjab Government. Interest on both the cases above is payable on 1st October every year. On 1st October 2006, she borrowed Rs 60,000 at 10 % p.a. to purchase Rs 50,000 , 9.5% securities of U.P. Government (due date of interest is 1 st March every year). Interest due on 1st March 2007 is received on 1st april 2007. Interest on loan taken on 1st October 2006 has been paid in the previous year 2007-08.

Solution : Computation of income from interest on securities for the assessment year 2007-07.

		Rs.
(i)	Rs 78,000, 9% less tax non-listed debentures	7,020
(ii)	Rs 89,000, 12 % securities of Punjab Govt.	10,680
(iii)	Rs 50,000, 9.5% securities of U.P. Govt.	4,750
	Gross Interest	22,450
	Less: Interest on loan taken $60,000 \times \frac{10}{100} \times \frac{6}{12}$	3,000
	Income from interest on securities	19,450

7.5 Meaning of Set off and Carry Forward of Losses :

Incomes under the various heads as discussed in preceding chapters are computed as per applicable provisions of the Act and are then aggregated. If there is a loss under a head, it can be adjusted against other incomes in accordance with the provisions of the act relating to set-off and carry forward.

Specific provisions have been made in the Income tax Act, 1961 for the set-off and carry forward of losses. Set-off means adjustment of losses against the profits from another source/head of income in the same assessment year. If losses cannot be set-off in the same year due to inadequacy of eligible profits, then such losses are allowed to be carried forward to next assessment year for adjustment against the eligible profits of that year. Further, for availing carry forward for any business loss or capital loss, the assessee is required to file a return of income u/s 139(3), before the due date. Section 32, 35 and 70 to 80, provide for set off and carry forward of losses/allowances. All losses are not allowed

to be carry forward. The following losses are only allowed to be carried forward and set off in the subsequent assessment year.

(i) House property loss

(ii) Business loss (Non speculative)

(iii) Speculation loss

(iv) Capital loss (Short term or long term)

(v) Loss on account of owning and maintaining race horses.

7.5.1 General :

(i) Loss from any source of income (except capital gains) can be set off against the income from any other source under the same head in the same assessment year.

(ii) Any short-term capital loss can be set-off against any capital gain (both long-term and short-term) in the same assessment year. Any long-term capital loss can be set off only against long-term capital gain in the same assessment year.

(iii) Loss under any head of income except capital loss can be set off against the income from any other head including capital gains (whether long-term or short-term) in the same assessment year .But , business loss shall not be set-off against Salary Income.

7.5.2 Capital Loss :

(i) Capital loss (both short-term and long-term) can be set off against capital gains only and against no other income.

(ii) Any short-term capital loss can be carried forward to the next eight assessment years and set off against 'capital gains'(short term or long term) in those years. Any long-term capital loss can be carried forward to the next following eight assessment years and set off only against long-term capital gain in those years.

7.5.3 Loss from House Property :

(i) Any loss under the head "Income from house property" will be set off against the income under other heads.

(ii) W.e.f A.Y. 1999-2000 , any loss under the head 'Income from house property', which cannot be and is not wholly set off against income under any other head, may be carried forward for eight years to be set off against income from house property in those years.

7.5.4 Business Losses/Allowances :

(i) Any business loss shall not be set off against 'salary' income.

(ii) Business losses (other than speculation loss) to the extent it is not adjusted against other incomes in the same year may be carried forward for eight years and set-off

against business income (from any business) for those years.

(iii) Unabsorbed scientific research expenditure can be carried forward and set off against income in subsequent years without any limit, till it is finally set off.

(iv) Unabsorbed scientific research expenditure can be carried forward and set off in subsequent years (without any limit).

(v) Loss in the speculation business can be set off against the income from any other speculation business but in case there is no other income from speculation business, the loss can be carried forward for being set off in four subsequent assessment years against income from speculation business.

(vi) Where a sole-property concern or a firm is succeeded by a company u/s 47 (xii) or (xiv) The unabsorbed loss or depreciation of the predecessor firm or sole proprietor, shall be deemed as the loss or depreciation of the successor company an allowed to be set off and carried forward, as per the provisions discussed above.

7.6 Mode of Set-off to be allowed against Taxable Income :

No particular mode of set-off has been prescribed by the income-tax law. In absence of any particular mode of set-off, the assessee is entitled to claim a set-off which is most beneficial to him.

(i) Intra-head Set-off is mandatory: Loss of one source has to be set-off against the profits of another source subject to the exception prescribed in this like partial set-off is not permissible. Intra-head set-off has to be done in full. Partial set-off is not permissible.

(ii) Inter-head Adjustment (Sec.71): If after setting – off the loss from one source against the income of another source, falling under the same head, the net result is still a loss, the loss under one head of income may be set off against the income of another head in the same previous year.

Exceptions to rule of aggregation under Inter-head adjustment :

(i) Speculation loss cannot be set-off against the income of any other head, e.g. salaries, house property, capital gains and other sources.

(ii) Business loss cannot be set-off against the income assessable under the head "salaries". It is operative from the assessment year 2005-2006 and subsequent years.

(iii) Capital loss, short –term loss or long-term, cannot be set-off against the income of any other head.

(iv) Loss from the activity of owning and maintaining race horses cannot be set-off against the income of any other head.

(v) Losses from gambling activity, e.g. loss from winning of lotteries, crossword puzzle, card games, betting on race horses etc cannot be set-off against the income of any other head.

Illustration 2: Set off and carry forward of capital loss and loss from house property :

Mr. A has the following income/loss during A.Y. 2008-09. Compute his taxable income:

(a) Long-term capital loss	Rs 20,000
(b) Net profit from business	Rs 50,000
(c) Net loss from a let out property	Rs 3,000
(d) Net loss from self-occupied residential property	Rs 7,000
(e) Business loss carried forward from A.Y. 2001-02	Rs 10,000

Solution :

(a) Profits and Gains of Business or Profession

Net Business Profit		Rs 50,000
(b) Capital Gains		
Long-term capital loss Rs 20,000 carried		
Forward to next year for being set off against		
'Long-term capital gains' (Note 1)		
(c) House Property		
(i) Net loss from let-out house property (Note 2)	(Rs 3,000)	
(ii) Net loss from self-occupied residential Property (Note 2)	(Rs 7,000)	(Rs 10,000)
Aggregate of Income		Rs 40,000
Less: Carried forward business loss For A.Y. 2001-02 (Note 3)		Rs 10,000
Gross/Taxable Income		Rs 30,000

Notes :

(i) From A.Y. 2003-04, long-term capital loss can be set off against long-term capital gains only. Long –term capital loss of Rs 20,000 (which is not set off) can be carried forward up to eight following assessment years of being set off against 'long-term capital gains' only.

(ii) Loss arising from any house property whether let-out or self –occupied can be set

off against income from any head, in the same year. Such loss which cannot be set off may be carried forward to subsequent eight years.

(iii) Business loss carried from A.Y.2001-02 can be set off against business income (from any business) up to eight subsequent year's i.e up to A.Y.2009-10.

Illustration 3 : For the previous year 2006-07 Mr. Das has a loss from manufacturing business of Rs 45,000 and an income from salary of Rs 93,000. He contends that since his salary income is less than the minimum exemption slab. It would be more beneficial for him to be able to carry forward the business loss to the next year rather than set it off against the salary income. Advise Mr. Das as to the correct viewpoint.

Solution : As per the rules, if there is 'eligible income' against which loss can be set off, then it is not the option of the assessee whether to set off or not. However as per the provisions of Section 71 loss from business cannot be set off against income from salary, thus in this case Mr. Das's gross total income for the previous year 2006-07 is Rs 93,000 and a loss of 45,000 will be allowed to be carried forward to the next 8 years to be set off in those years against income only from the head 'Business and profession'.

Suggested Questions :

1) Discuss how the following heads are chargeable under Income tax :

   (i) Dividends

   (ii) Owning and maintaining race horses.

2) How letting of Plant and Machinery along with Building is chargeable to income tax?

3) Discuss the deductions allowable under 'Other sources of Income.'

4) What do you understand by set off and carry forward of losses?

5) Explain the procedure of set off and carry forward of loss in case of

   (i) Capital loss

and (ii) Loss from House Property?

UNIT VIII

TAXATION OF COMPANIES

Learning Objectives : At the end of this unit, students will understand the following aspects regarding taxation of companies:

- Kinds of Companies
- Residence of Company
- Computation of Total Income
- Assessment of Companies
- Rate of Tax
- Minimum Alternative Tax

8.1 Kinds of Companies :

A Company is a separate legal entity under the companies act, 1956. Under the Income tax Act 1961, the definition of Person includes a Company and hence a company is assessed to tax independently. Assessment of company means and includes the computation of its total income and calculation of its tax liability. For the purpose of taxation, companies are broadly classified as under:

(I) Domestic Company

(II) Foreign Company

(I) Company :

As per section 2(17), a company means:

(i) any Indian company, or

(ii) any body corporate incorporated by or under the laws of a country outside India,

or (iii) any institution, association or body which was assessed as a company for the assessment year under the Income-tax Act,1922 or was assessed under this Act as a company for any assessment year commencing on or before 1-4-1970,

or (iv) any institution, association or body , whether incorporated or not and whether Indian or Non-Indian, which is declared by a general or special order of CBDT to be a company.

(II) Indian company [Section 2(26)]: 'Indian Company' means a company formed a registered under the Companies Act, 1956 and includes-

(i) a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir and the union territories);

(ii) a corporation established by or under a Central , State or Provincial Act;

(iii) any institution, association or body which is declared by the Board to be a company;

(iv) in the case of the State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in that State;

(v) in the case of any of the Union territories of Dadra and Nagar Haveli, Goa Daman and Diu, and Pondicherry, a company formed and registered under any law for the time being in force in that Union territory.

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

(III) Domestic Company [Section 2(22A)] :

A domestic company means an Indian company or any other company which in respect of its income, liable to tax under the Income-tax Act, has made the prescribed arrangements for the declaration and payment within India, of the dividends (including dividends on preference shares) payable out of such income.

(IV)Foreign Company [Section 2(23A)] :

Foreign company means a company which is not a domestic company.

(V) Private Company [Sec 3 (iii) of Companies Act, 1956] :

Private company means a company which has a minimum paid –up capital of Rs 1,00,000 or such higher paid –up capital as may be prescribed and which by articles :

(i) Restricts the right to transfer its shares , if any ;

(ii) Limits the number of its members to 50; and

(iii) Prohibits any invitation or acceptance

8. 2 Residence of a Company [Section 6(3)] :

A company is said to be a resident in India during the relevant previous year if : (a) it is an Indian Company , or (b) if it is no an Indian Company then, the control and the management of its affairs is situated wholly in India.

The company is said to be non-resident in India if it is not an Indian company and some part of the control and management of its affairs is situated outside India.

8.2.1 Computation of Total Income :

The total income of a company is also computed in the manner in which income of

any other assessee is computed. The first step in this direction is to ascertain Gross Total Income. Income computed under four heads (salary head is not applicable), is aggregated. While aggregating the income, section 60 and 61 shall be applicable. Further effect to set-off of losses and adjustment for brought forward losses will also be done. From Gross total Income so computed deductions available under chapter VIA (SECTION 80A to 80U) should be allowed. Such deductions allowable to a company assessee includes 80G, 80GGA, 80GGB, 80-IA, 80-IB,80-IC, 80JJA,80JJAA

8.2.2 Assessment of Companies :

(I) The principal officer of the company is required to the file the return of total income of the company upto 30th September of the assessment year. A Company is assessed like any other assessed. But, its liability differs from other assesses on the following points:

(i) There is no exemption limit in the case of a company. It has to pay tax on its total income. No part or portion of its income is exempt from tax. Thus even if a company's total Income is Rs. 10, it shall pay tax on it.

(ii) It has to pay tax at a flat rate on its total income. There is no Slab system of levying tax in the case of a company assessee.

(iii) A Company is classified into three categories:

- Domestic company in which public are substantially interested. Such companies are called widely held domestic companies
- Domestic companies in which public are not substantially interested. Such companies are called closely –held domestic company
- Foreign companies

(II) Principal Officer [Sec. 2(35)]:

"Principal Officer" means:

(i) The secretary, treasurer, manager or agent of the company; or

(ii) Any person connected with the management or administration of the company upon whom the assessing Officer has served a notice of his intention of treating him as the Principal Officer thereof.

8.3 Rate of Tax :

The rates of tax applicable to companies for the Assessment year 2008-2009 are as under -

A. Domestic company (Both Public and Private Company) :

- Long term capital Gains 20%
- Short term capital Gains u/s111A 10%
- Other Incomes 30%

B. Foreign Company

- Long term capital Gain 20%
- Short term capital Gain u/s 111A 10%
- Income from Royalty or fees for technical services from Government or Indian Concern. 10%
  (In pursuance of an agreement made after 31.5.2005)
- Other Incomes 40%

Note: Surcharge on amount of Income Tax is levied on all companies if total income of the company exceeds Rs 1 crore but the rate of surcharge on Domestic Company is 10% and on Foreign company is 2.5 %. Also Education Cess @ 3% is levied on all companies on the amount of income tax and surcharge calculated as per above rate

8.4 Minimum Alternative Tax (MAT) :

Since the P&L account of the companies is made as per provisions of the Companies Act ant the tax is calculated as per provisions of the Income tax Act therefore there were companies which were declaring dividend because they had book profits but since they had no chargeable income under the I.T. Act they were not paying any Tax, such companies were called Zero Tax Companies. The variance in profits as computed under the Companies Act and the Income Tax Act was mainly because of the difference in the rates of depreciation under the two Acts. By following the lower rates of depreciation under the Companies Act the company could declare higher profits to the shareholders and by charging higher depreciation as per Income Tax Act the company could declare lower income.

To curb this practice section 15JA for MAT was inducted in the Act applicable up to assessment year 2000-01. Sec 115JA was replaced with Sec 115 JB from assessment year 2001-02. This section has been amended by Finance Act 2006.

8.4.1 Provisions of MAT for payment of tax by certain companies [Section 115 J B]

(I) Tax payable for any assessment year cannot be less than 10% of book profit :

Where in the case of a company, the income-tax payable on the total income as computed under the Income-tax Act, is less than 10% of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income (book profit) shall be the amount of the income-tax at the rate of 10%. Surcharge and Education cess as applicable shall be added to the tax determined as above as per section 115JB to find net MAT liability.

Rate of tax inclusive of surcharge and Education Cess for assessment year 2008-2009 shall be as under :

A. If book profit does not exceed Rs 1 crore

	I.T	Surcharge	EC	SHEC	Total
Domestic Company-	10	0	0.2	0.1	10.30
Foreign Company-	10	0	0.2	0.1	10.30

B. If Book profit exceeds Rs1 crore

Domestic company	10	1	0.22	0.11	11.33
Foreign Company	10	0.25	0.205	0.1025	10.555

The following points should be kept in mind for computing Book Profit for MAT Tax :

(i) Profit and loss of the company to be prepared as per provisions of the Companies Act. Every company shall for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of Parts II and III of schedule VI to the Companies Act, 1956. While preparing the annual accounts including profit and loss account : (i) the accounting policies of the company ; (ii) the accounting standards followed by the company for preparing such accounts including profit and loss account ; (iii) the method and rates adopted for calculating the depreciation by the company; shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account as laid before the company at its general meeting in accordance with on the provisions of section 210 of the Companies Act, 1956.

(ii) Computation of book-profits [Explanation to 115JB (1) and 2]:The net profit as shown in the profit and loss account (prepared as per Part II and III of Schedule VI) for the relevant previous year, shall be increased or reduced by the specified adjustments

(iii) The company shall furnish a report from a chartered accountant in Form No 29 B that the Book profits have been computed as per the applicable provisions of MAT along with the return of Income.

(iv) Income accrued or arisen after March 31, 2005 from any business/ services in the hands of an entrepreneur/developer in tax special economic zone will not be subject to MAT

8.4.2 Tax Credit for MAT :

Since MAT is a deemed tax based on book profit of a company, Section 115JAA provides that –

Where a company has paid MAT u/s 115JB for assessment year 2006-2007 or any subsequent year , it shall be allowed a tax credit to be set-off against tax payable at normal rates (as per normal provisions of the act excluding Section 115JB) in any of the

seven subsequent assessment years as per section 115JAA.

Illustration 1 :

X Ltd an Indian Company submits the following particulars for the year ended 31.3.2008

Business Income (after debiting the following) Rs 420000

a. Depreciation Rs 240000

b. Interest on public deposits paid Rs 35000

Compute Income tax liability of the company for assessment year 2008-2009 considering the following further information-

a. Allowable Depreciation as per Income tax rules Rs 310000

b. Book Profit of the company u/s 115JB amounted to Rs 1400000

Solution: Computation of total Income (as per normal provisions)

1. Business Income :

Net Profit as per P/L a/c	420000
Add: Depreciation as per Books	240000
	660000
Less: Depreciation allowable as per I.T Rules	310000
Total Income	350000

Tax on Total Income

Tax @ 30% on Rs 350000	**105000**

Tax under MAT

Book Profits	1400000
Tax @ 10%	**140000**
Tax payable by the company (Higher of Normal tax or MAT)	140000

Note – Applicable surcharge and E. cess to be added to final tax liability of Rs 140000

8.5 Special provisions relating to tax on distributed profits of domestic companies :

(I) Tax on distributed profits of domestic companies [Section 115-O] :

A Domestic Company shall, in addition to the income-tax chargeable in respect of its total income, shall also be liable to pay additional income-tax on any amount declared,

distributed or paid by such company by way of dividend (whether interim or otherwise) on or after 1-4-2003, whether out of current or accumulated profits. Such additional income-tax shall be payable @ 15% plus applicable surcharge and education cess of the amount so declared, distributed or paid as dividends This additional tax shall be payable even if no income-tax is payable by such company on its total income. The provisions of section 115-O are not applicable to a Foreign company i.e a Foreign Company is not liable to dividend tax. The effective rate of dividend tax including surcharge and Education cess for the assessment year 2008-2009 comes to 16.995 (15+ 1.5 + 0.495)

For the purpose of section 115-O the expression dividend shall have the same meaning as given to dividend under section 2 (22) of the Act but it shall not include sub-clause (e) of section 2 (22)

Similar provisions on income distributed to Unit holders by Mutual Funds are contained in section 115R, 115S, and 115T of the Income Tax Act.

(II) Tax on distributed profits not allowed as deduction :

The company or the shareholder shall not be allowed any deduction in respect of the amount which has been charged to tax or the tax thereon under any provisions of the Income-tax Act.

(III) Interest payable for non-payment of tax by the domestic companies [Section 115P] :

The tax shall be deposited within 14 days from the date of declaration, distribution, or payment of dividend whichever is earliest.

Where the principal officer of a domestic company and the company fail to pay the whole or any part of the tax on the distributed profits referred to in section 115-O (1) within the time, he or it shall be liable to pay simple interest @ 1% for every month or part thereof on the amount of such tax for the period beginning on the date immediately after last date on which such tax was payable and ending with the ate on which the tax is paid actually.

(IV) When companies deemed to be in default [Section 115Q] :

If the principal officer of a domestic company and the company does not pay tax on distributed profits in accordance with the provisions of section 115-O, then he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of the Income-tax Act for the collection an recovery of income-tax shall apply.

8.6 Other Provisions – Effect of sec 115JB (2) :

Every assessee, being a company shall for the purposes of this section, prepare its profit and loss account for the relevant previous year in accordance with the provisions of

Part II and III of Schedule VI to the Companies Act, 1956. Provided that while preparing the annual accounts including profit and loss account:

(i) The accounting policies;

(ii) The accounting standards followed for preparing such accounts including profit and loss account;

(iii) The method and rates adopted for calculating the depreciation; shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account and laid before the company at its annual general meeting in accordance with the provisions of section 210 of the companies Act, 1956.

8.7 Unabsorbed Depreciation or Losses which can be carried forward [Sec 115 JB(3)] :

Although, the assessee is liable to pay tax @ 10% (plus surcharge as applicable) of the book profits if its total income computed as per Income tax act is less but it is entitled to determine unabsorbed depreciation u/s 32(2), business less u/s 72(1), speculations loss u/s 73 and capital loss u/s 74 and loss u/s 74 A and shall be allowed to carry forward such unabsorbed depreciation or losses to the subsequent year (s) for claiming set off as per the normal provisions of Income Tax Act.

Suggested Question :

1) What do you understand by company? What are the kinds of companies under the Income tax Act?

2) Discuss the reasons for levying of MAT?

3) Write short notes on : (i) Principal Officer (ii) Assessment of companies

4) Discuss 'Residence of a company'.

5) How is total income of a company computed?