



# ANNAI WOMEN'S COLLEGE

## DEPARTMENT OF COMMERCE(CA)

### COURSE MATERIAL

### INCOME TAX THEORY LAW & PRACTICE

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## **Unit – I**

### **Basic Concepts**

#### **Introduction**

'Tax' levied by the government is a 'multidimensional instrument'. It helps resource mobilization, helps government to take up schemes and projects for economic development. It is an instrumental tool to procure resources for the government to enable it to formulate policy schemes for the overall development of the economy. Moreover, taxation measures are relied upon for financing socio-economic development and also to check and reduce the monetary inequalities in the society.

Thus, taxation plays an important role as a source of revenue and an effective measure of removal of economic disparity.

#### **Structure of Indian taxation system:**

Indian taxation system is one of the world's largest taxation system in terms of its wide application on large number of people and other business entities. It is a well structured system derived from the Indian constitution. As we know that India has a federal system of government with clear demarcation of power between the central government and the state government. Like political set up of governance, the tax administration is also based on clear demarcation between central government and state government at first instance and then between state governments and local bodies. According to the constitution of India, the government has the right to levy taxes on individuals and other artificial bodies/organisation.

#### **Q: Explain the importance of taxation.**

##### **Importance of taxation**

- It provides sufficient revenues to the State.
- It plays a vital role as a source of revenue and a measure of removal of economic disparity.
- It helps the Government to mobilize the resources by imposing tax on the privileged ones.
- It helps government to take up schemes and projects for economic development.
- It helps for achieving social and economic objectives of welfare of a state, like reduction of inequalities and the enlargement of opportunities to the common man.

#### **Q: Brief history of income tax in India.**

##### **Historical backgrounds of taxation in India:**

Taxation in India till now, from the following

- |      |                                                                      |
|------|----------------------------------------------------------------------|
| 1860 | Introduction of tax by Sir James Wilson                              |
| 1886 | Separate Income Tax Act was passed                                   |
| 1918 | New Income tax act was passed                                        |
| 1922 | Another act was passed                                               |
| 1956 | Reference of law commission                                          |
| 1957 | Submission of report by law commission                               |
| 1958 | Submission of report by Direct Tax authorities Enquiry Committee     |
| 1961 | Framing of Income Tax Act 1961                                       |
| 1962 | Income Tax Act 1961 was brought to force on 1 <sup>st</sup> of April |

#### **Q: Explain the objectives of taxation.**

## **Objectives:**

The basic objective of taxation is to raise resources for the State. In fact, experts like David. A. wells contend that “Taxation is for revenue only and a so called tax which looks to anything besides the securing of revenue is not a tax, but an unconstitutional exercise of the taxing power”.

However, all the modern States in the post second world war era have realized that taxation is a powerful instrument with multiple applications. It can be used to reduce inequalities, to accelerate economic development, as a tool to regulate consumption, imports and exports, in addition to its basic objective of raising revenues. Different objectives of taxation may be summed up as under.

### **1. Objective of raising revenue.**

### **2. Regulatory objectives.**

- Regulating consumption.
- Regulating production.
- Regulating imports and exports.
- Regulating the effects of inflation, depression etc.

### **3. Developmental objectives.**

- Objective of economic development.
- Objective of capital formation.
- Objective of increasing employment opportunities.

### **4. Objectives of reducing inequalities.**

- a. Reduction in economic disparities.
- b. Reduction in regional imbalances.

## **Q: what are canons of taxation?**

### **Principles or Canons of Taxation:**

It refers to the principles of taxation. In other words it refers to the basis on which the income is taxed. These principles are essential for a good taxation policy. Adam Smith was the first economist who enunciated specific canons of taxation. His four canons of taxation have become ‘Classical’ in any literature of taxation and public finance. Some other western experts on Public Finance like Bastable have added a few more canons of Taxation of the four canons of Adam Smith. The following are the important principles (Canons) of taxation.

#### **• Canon of Equality**

This also known as “Principles of equity”. This principle is mainly based on ‘justice’ that is all assesses should be treated equally. In other words, the burden of taxation must be distributed equally. The outcome of this principle is that the person who earns more income should pay more tax and the person who earns less income should pay lesser tax.

#### **• Canon of certainty**

Under this principle, certainty regarding time of payment, manner of payment, amount to be paid, the authority to whom the tax should be paid are discussed i.e. the tax amount to be paid should be certain and clear.

The outcome of this principle is as follows.

- a. Certainty of effective incidence
- b. Certainty of liability
- c. Certainty of revenue to the treasury

#### **• Canon of economy**

This principle deals with cost of collection and it states that the cost of collection should be Minimum. The basis of this principle is that imposing taxes which are widespread and difficult to administer will be of no use. Minimum expenditure collection principle should be followed.

#### **• Canon of convenience**

This convenience principle concentrates on the tax payer. This principle states that the assessee should feel convenient regarding the exact mode and timing of tax payment.

- **Canon of productivity**

This is termed as fiscal adequacy. It states that the system will generate inflow to the treasury. i.e it will bring revenue to the treasury. This principle also concentrates and implies that the tax system of generating revenue should not adversely the production.

- **Canon of simplicity**

The tax system should be made as simple as possible, in such a way that even a layman can understand it. The tax procedure, rules, regulation etc., are to be simple giving room for easy understanding.

- **Canon of diversity**

Under this principle, multiple tax system should be followed. It suggests that the tax system should be of diverse nature. It is on the assumption that too much dependence on fewer sources of public revenue would lead to a lot of uncertainty to the treasury. Mixture of direct tax and indirect tax should be followed.

- **Canon of expediency**

This principle concentrates on

- a. Economic expediency
- b. Social expediency
- c. Political expediency

This principle states that tax determination should not give room for any criticism.

- **Canon of coordination.**

This principles state that there should be coordination among the different taxes as and when they are imposed by the tax authorities.

**Q: Explain the following definition:**

(a) Agricultural income, (b) Assessee, (c) Deemed assessee, (d) Average Rate and Maximum Marginal Rate, (e) Block of assets, (f) Charitable purpose and child, (g) Fair market value, (h) Company, (i) Person, (j) Previous year (k) Assessment year, (l) Incomes.

**Agricultural Income [Sec.2 (1A)]**

Agricultural income is fully exempted for tax u/s 10(1). Agricultural income refers to

- a. Any rent or revenue derived from land, which is situated in India and used for agricultural purposes
- b. Any income derived from such land, which is used for agricultural operations. It includes process by cultivator or receiver of rent in kind as well as in cash or receipt of sale of such produce.
- c. Any income from a farm house
- d. Any income derived from saplings or seedlings grown in a nursery will be deemed as agricultural income (w.e.f .AY 2009-10)
- e. Agricultural income is a factor in determining the tax on non-agricultural income in the case of certain non-corporate assesses like individuals, H.U.F, unregistered firms, AOP's etc.

**Non agricultural incomes from land:**

Certain incomes are derived from land but they are not agricultural incomes because the basic conditions –land must be used for agricultural purposes and it must be the primary source of income are not satisfied in such cases. Sources of the incomes falling under such categories are as follows:

- Income from sale of forest trees, fruits, wild grass and reeds of spontaneous growth.
- Income from fisheries.
- Royalty income of mines.
- Income from poultry farming, dairy farm etc.
- Incomes from land used for quarries, ferries supply of water for irrigation, potteries or brick fields are not agricultural incomes.

- Income derived from land let out for storing crops.
- Income from interest on arrears of rent in respect of agricultural land.
- Income from sale of salt.
- Interest income of money lender received in the form of agricultural produce.
- Income derived from sale of rubber.
- Income from market

### Partly agricultural income:

Sometimes income may comprise both agricultural and non-agricultural components. In such cases, agricultural components of the total income are exempted, whereas non agricultural component of the total income should be chargeable to tax. This type of income is computed as per rules 7 and 8 of income tax, 1962.

### Assessee [sec. 2(7)]

Assessee refers to the following persons as per income Tax Act 1961.

- Any person who is liable to pay tax or
- Any person who is liable to pay interest or penalty or
- A person who is deemed to be an assessee as per the act or
- A person who is considered as default assessee by the Act or
- Any person on whom some assessment of fringe benefit is carried out [ from the AY 2006-07]
- Any person who is entitled for refund of tax

### A. Ordinary Assessee

An ordinary assessee is one who has to pay any tax, penalty, and interest to the income tax authority or who is eligible for any refund of tax from the tax authorities.

### B. Representative or Deemed Assessee

Deemed assessee is also known as representative assessee. This type of assessee is not only responsible for his income but also responsible for the income of the other person to whom he acts as a representative. For example if Mr.Sanker cares of a minor, then Mr.Sankar is responsible for his income as well for the income of the minor.

Particular	Deemed assessee
For a minor	Guardian
For a non-resident	Agent
For deceased person[ with will]	Executor
For deceased person [with out will]	Legal heir or the eldest in the family

### C. Assessee-In-Default

A person is deemed to be an assessee-in-default if he fails to fulfill his statutory obligations. In case of an employer paying salary or a person who is paying interest it is their duty to deduct tax at source and deposit the amount of tax so collected in government treasury. If he fails to deduct tax at source or deduct tax but does not deposit it in the treasury, he is known as assessee-in-default.

### Initiation of Proceeding

The proceeding must be initiated under the provisions of the act. An enquiry letter is sent by the department to a person without reference to a specific section of the act, it is no proceeding under the act and the person cannot be said to be an assessee for the income tax purposes.

### Average Rate [Sec.2 (10)]

“Average rate of income-tax” means the rate arrived at by dividing the amount of income-tax calculated on the total income by such total income.

$$\text{Average Rate} = \frac{\text{Total Tax}}{\text{Totl Income}} \times 100$$

### **Maximum Marginal Rate (MMR) Sec.2 (29c)**

It means the rate of tax for an individual, which is applicable on highest slab on income. At present for assessment year 2010 – 2011 it is 30%.

### **Block of Assets [Sec.2 (11)]**

It means a group of assets falling within a class of assets comprising:-

- a. Tangible assets being building, machinery, plant or furniture.
- b. Intangible assets being know-how, patents, copyrights trade marks licenses, franchises or any other business or commercial rights of similar nature.

In respect of which same percentage of depreciation is prescribed. This simply means that all assets of the same nature and having same rate of depreciation would form one block of assets. For example all machines having 15% rate of depreciation would form one block and all machines having 40% rate of depreciation would fall in another block of assets.

### **Charitable Purpose [Sec.2 (15)]**

“Charitable purpose” includes- a. Relief of the poor; b. Education; c. Medical relief ;d. Advancement of any other object of general public utility.

It is further provided that any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business or any activity of rendering any service in relation to any trade, commerce or business for a cess or fee or any other consideration irrespective of the nature of use or application or retention of income from such activity.

### **Child [Sec.2 (15a)]**

“Child” in relation to an individual, includes a step-child and an adopted child of that individual. It includes both male and female children.

### **Fair Market Value [FMV] [Sec.2 (22)]**

The “fair market value” in relation to a capital asset means-

- a. The price that capital asset would ordinarily fetch on sale in the open market on the relevant date; and
- b. Where the price referred to in sub-clause (i) is not ascertainable, such price as may be determined in accordance with the rules made under this act.

### **Company [sec. 2(17)]**

For all purposes of the Act the term ‘Company’, has a much wider connotation than that under the Companies Act. Under the Act, the expression ‘Company’ means:

- a. Any Indian company as defined in section 2(26); or
- b. Any body corporate incorporated by or under the laws of a country outside India.
- c. Any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act; or
- d. 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 the CBDT.

### **Person (sec. 2(31))**

The word person is a very wide term & embraces in itself the following

- **Individual:**

It refers to a natural human being whether male or female, minor or major.

- **Hindu in divided family:**

It is a relationship created due to operation of Hindu law. The manager of HUF is called “karta” and its members are called “coparceners”.

- **Company:**

It is an artificial person registered under Indian companies act 1956 or any other law.

- **Firm:**

It is an entity which comes into existence as a result of partnership agreement. The income tax act accepts only these entities as firms which are assessed as firms under Section 184 of the act.

The only condition for a partnership entity to be assessed as firm is that it must submit its instrument of partnership (partnership deed) duly authenticated by all partners except a minor partner and it must specify the shares of the partners. In case firm has not submitted its partnership deed it is assessed as firm u/s 185.

- **Association of persons or body of individuals :**

Co-operative societies, MARKFED, NAFED etc, are the examples of such persons. When persons combine together to carry on joint enterprise and they do not constitute partnership under the ambit of law, they are assessable as an association of persons. An AOP , can have firms, companies , associations and individuals as its members. A body of individuals (BOI) cannot have non-individuals as its members. Only natural human beings can be members of a body of individuals.

### **Distinction between AOP and BOI**

a. A BOI has to consist of individuals only. An AOP may consist of non-individuals also. If two or more person (like firm, company, HUF, individuals etc) joint together, it is called an AOP. But if only individuals join together, it is called a BOI.

b. An AOP may be formed by voluntarily getting together for a common design or in combination, will be engaged in income producing activities, whereas a BOI may or may not have such common design or will

- **Local authority:**

Municipality, panchayat, cantonment board, port trust etc. are called local authorities.

- **Artificial juridical person:**

1. A public corporation established under special Act of legislature and body having juristic personality of its own is known to be artificial juridical persons. Universities are an important example of this category.

2. Association of persons or body of individuals or a local authority or artificial judicial persons shall be deemed to be a person whether or not such persons are formed or established or incorporated with the object of deriving profits or gains or income.

### **Assessment Year [Section 2(9)]**

“Assessment Year” means the period of 12 months commencing on the 1st day of April every year and ending on 31st March of the next year. The current assessment year starts from 1<sup>st</sup> April 2014 and ends on 31<sup>st</sup> March 2015.

The taxpayer’s income of the previous year is assessed to tax in the assessment year at the rates prescribed in the Finance Act for the assessment year.

**Current Assessment Year- 1.4.2014 - 31.03.2015**

### **Previous Year (Section 3)**

Pervious year refers to twelve months immediately preceding the particular assessment year. If the assessment year is 2014-15, then previous year will be 2013-14 – Starting from 1<sup>st</sup> April 2013 to 31<sup>st</sup> March 2014.

The term previous year is very important because it is the income earned during the previous year which is to be assessed to tax in the assessment year. As the word ‘**Previous**’ means ‘**Coming Before**’, hence it can be simply said that the previous year is the financial year preceding the assessment year e.g. for the assessment year 2014-2015 the previous year should be financial year ending 31<sup>st</sup> March 2014.

In simple words, it may be said that the year in which income is earned is called previous year and the next year in which such income is computed and put to tax is known as assessment year.

**Current Previous Year- 1.4.2019 - 31.03.2020**

**Q: Write short note on income [section 2(24)]**

**Income [Sec. 2(24)]**

The definition of the term “income” in sec. 2(24) is inclusive and not exclusive. The term “income” not only indicates those things which are included in sec. 2 (24), but also includes such thing which the term signifies according to its general and natural meaning. The definition of “income” includes—

1. Profits and gains;
2. Dividend;
3. Voluntary contributions received by religious or charitable trust or institution;
4. Perquisite or profit in lieu of salary taxable under sec. 17(2) and (3);
5. Special allowance or benefit, other than perquisite as in sub-clause (4) above
6. Allowance granted to assessee
7. The value of any benefit or perquisite obtained from the company by a director or by a person having substantial interest in the company or by a relative of the Director of such person;
8. Any sum paid by a company in respect of any obligation which, but such payment would have been payable by the director or the person having substantial interest;
9. Value of any benefit or perquisite obtained by a representative assessee mentioned in sec. 160(1)(iii) or (iv) or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee.
10. Any compensation or other sum due to or received by any person referred to in sec. 28 (ii)
11. Business income includes—
  - Compensation money [sec. 28(ii)]
  - Income derived by a trade, professional or similar association for specific services performed for its members [sec. 28(iii)]
  - Export incentives [sec. 28(iii a), (iii b), (iii c)]
  - Value of any benefit or perquisite arising from business or the exercise of profession
  - Any interest, salary, bonus, commission or remuneration received by a partner of a firm from such firm [sec. 28(v)]
  - Deemed business income and deemed income chargeable under the head other sources
12. Any capital gains chargeable u/s. 45;
13. Profits and gains of any insurance carried on by a mutual insurance company or by a cooperative society;
14. Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort;
15. Sum received by the assessee from his employees as contributions to any provident fund or superannuation fund set up under the provisions of the Employees’ State Insurance Act, 1948
16. Any sum received under key-men Insurance.

The above list given in sec. 2(24) of the income-tax Act is inclusive and not exhaustive.

**Q: What are the features of income?**

**Features of income:**

The following are some important principles or features which explain the concept of “income”.

- **Sources of income**

The “income” connotes a periodic monetary return coming with some sort of regularity or expected regularity from definite sources. The source however need not necessarily be one which is expected to be continuously productive, but it must at any rate be one whose object is the production of a return.

- **Basis of income**



The income arises either on receipt basis or accrual basis. If the assessee has got a right to receive the income he is liable to be taxed on such income on accrual basis even if he may not have received the income.

- **Form of income**

Income may be realized in the form of money or money's worth. i.e., in cash or in kind. When income is realized in kind, its valuation is made according to the prescribed rules.

- **Nature of income**

The income tax law does not make any distinction between legal income and income tainted with illegality. Illegal income is taxable like legal income to hold otherwise would be to put a premium on dishonesty and fraud.

- **Title of income**

Assessment of income cannot be held up because of any dispute regarding the title of the income. The recipient is taxable although there may be a rival claim to the source of income. Where money has been received, a rival claim or a threat of litigation cannot make the income contingent one. On the other hand, a mere claim by a person against another who has actually received the money is not sufficient to make income accrue to the claimant and render him liable for tax.

- **Quantum of income**

A revenue receipt is always liable to tax whether it is received in lump-sum or in installments. For example, arrears in pay revision received in lump-sum, is income.

- **Tax free-income**

If some tax-free income is received by the assessee, it has to be grossed up for inclusion in his total income.

- **Real income alone is taxable**

“Income” should refer to real income and not fictional or technical income. Transactions entered into by commercial men must be looked at for income-tax purposes from a commercial point of view and in trying to determine whether a certain transaction resulted in profits, we have to see whether the transaction resulted in real profits.

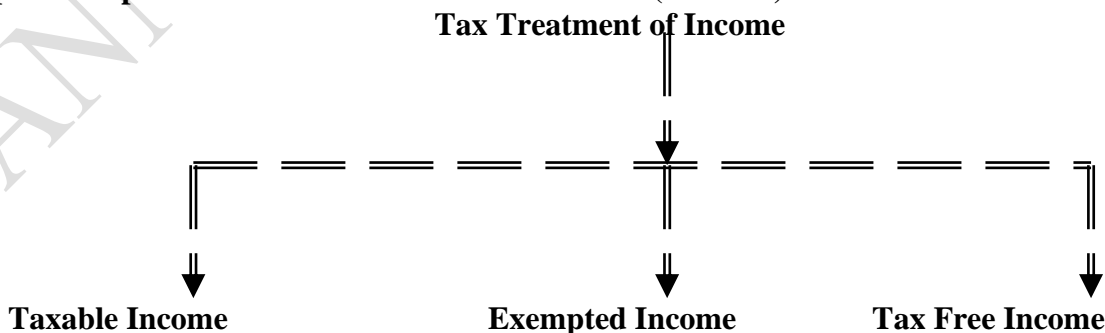
- **Negative income**

Losses are negative profits. Both positive and negative profits are of a revenue character and both must enter into computation of total income.

- **Surplus arising from mutual activity**

No person can trade with himself and make an assessable profit. If different persons combine themselves into distinct and separate legal entity for the purpose of rendering services to themselves, the resulting surplus is not assessable to tax if the surplus is to be refunded to the members. There should be complete identity between the contributors and the participators. Thus, a members club cannot be charged to tax on the profits it has made by overcharging its members for the supply of refreshments, beverages and other amenities.

**Q: Explain the procedure for tax treatment of income (5 marks)**



**1. Taxable Income**

These incomes from part of total income and is fully taxable. These are treated u/s 14 to 69 of the act. These are salaries rent, business profits, professional gain, capital gain, interest, dividend, winnings from lotteries, races etc..

## 2. Exempted Income

These incomes do not part of total income either fully or partially. Hence no tax is payable on such incomes. These incomes are given u/s 10(1) to 10(32) of the act.

## 3. Rebate able (Tax free) Income

These incomes form part of total income and are fully taxable tax is calculated on total income out of which a rebate of tax at average rate is allowed.

### Q: Explain the concept of income.

#### Concept of income:

- Any amount received due to devaluation of currency is taxable income.
- If income is diverted without receiving, it is not taxable income.
- If income is collected and then distributed that income will be taxable income.
- Any loss is also included under the concept of income.
- Income must be from a definite source in order to get it taxed.
- Self generated income can not be taxed. Therefore income must be from outside.
- Legal as well as illegal income is taxed.
- It is not necessary that income should be in the form of money. It can also be in the form of kind.
- Income earned may be temporary or permanent.
- Pin money received by housewife is not considered as an income.
- In case there is any dispute regarding the title of the income, the beneficiary will be taxed.
- Income may be a lumpsum or in installment.
- Revaluation of assets and excesses if any can not be considered as income.

### Q: Write short note on casual income.

#### Casual income:

Any receipt which is of a casual and non-recurring nature is casual income. In other words, casual income is that income the receipt of which is accidental and without any stipulation. It is in nature of an unexpired wind-fall winning from lottery, crossword puzzles, card games and other games of any sort are casual incomes. Receipts even from habitual betting are non-recurring receipts and assessable as casual income. The casual income does not include:

- a. Capital gains, chargeable under the provisions of section 45; or
  - b. Receipts arising from business or the exercise of a profession or occupation; or
  - c. Receipts, by way of addition to remuneration of an employee, such as bonus, gratuity, perquisites etc.
2. Voluntary payments received in exercise of an occupation are not treated as casual income.
  3. A gift from a relative is not income at all. Birthday and wedding gifts are simplest instances in point. A gift from a relative does not become income merely because it is repeated year after year.
  4. Payment by husband to his wife under an agreement to live a part as maintenance allowance is neither casual income nor a personal gift. Hence, it is taxable.
  5. Prize awarded for coin collection or stamp collection may be a casual income. This income is due to hobby.

### Q: Write short note on Gross total income and total income.

## **Gross Total Income (sec.14)**

It means the Gross Total Income computed in accordance with the provision of the income tax Act, before making any deduction under sec. 80C to 80U.

After aggregation income various heads, losses are adjusted and the resultant figure is called "GROSS TOTAL INCOME"

### **Five Heads of Income:**

- Income under the head "Salaries"
- Income under the head "House Property",
- Income under the head "Profits and Gains of Business or profession",
- Income under the head "Capital Gains",
- Income under the head "Other sources"

### **Q: Explain the Total Income**

#### **Total Income [sec.2 (45)]**

Total income means the total amount of income referred to in sec.5, computed in the manner laid down in the IT Act. Under Sec. 5, different incomes of an assessee are included in his total incomes is done according to the provisions of different sections of the Act under the heads of salaries, HP, Business or Profession, Capital Gain and Other Sources. In other words, total income means the amount left after making the deductions under sec. 80C to 80U from the GTI.

## **BASIS OF CHARGE, RESIDENTIAL STATUS**

### **Basis of Charge: (Sec. 4)**

Income tax is to be charged on the total income of the previous year of a person at the rate fixed for the assessment year by the Annual Finance Act. The total income of a person is determined in accordance with the provisions of the Income Tax Act; but the tax is charged according to the Finance Act which is passed by the parliament every year.

Tax is levied on total income of assessee under the provisions of Income Tax Act, 1961, the total income of each person is based upon his residential status **Section 6** of the Act divides the assessable persons into three categories;

- **Ordinary Resident**
- **Resident but not ordinarily resident ; and**
- **Non – Resident**

**Residence and citizenship are two different things.** The incidence of tax has nothing to do with citizenship. An Indian may be non – resident and a foreigner may be resident for income tax purposes. The residence of a person may change from year to year but citizenship cannot be changed every year.

### **Q: What is meant by residential status?**

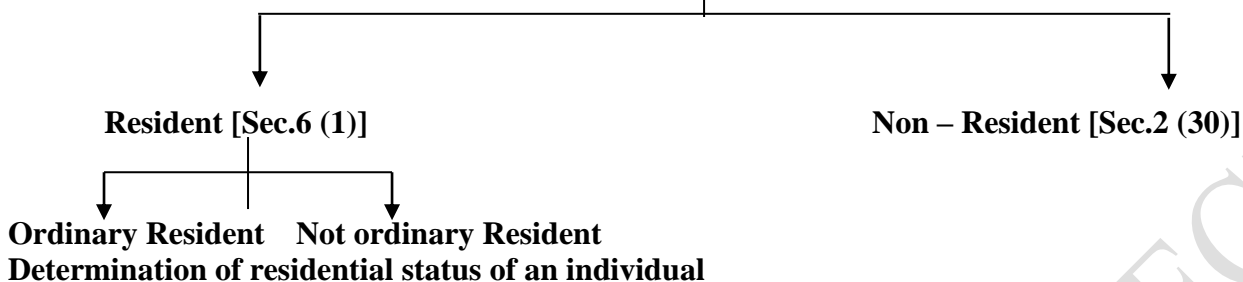
#### **Residential status:**

Section 6 of the income tax Act deals with the residential status. The concept of residential status is no way connected to the nationality of a person. A person would have born in India but for tax purpose he may be a non-resident. Similarly a person who has born and brought up in a foreign country may be a resident Indian for tax purposes. The status of a person is identified by considering the number of days he has stayed in India in a particular previous year. Different rules are prescribed for the residential status of different kinds of assessee (say Individual, HUF, Firm, Company, BOI, AOP, other personal. A person can

be resident in more than one or two country in the same financial year. It is not necessary that the same status should be there every year. The status of a person may change from year to year.

**Q: Explain the procedure to determine the residential status of an individual (5 or 10 marks)**

### Resident status of Individual (Sec.6)



**Determination of residential status of an individual**  
Residential status of an individual depends upon the fulfillment of the following basic and additional conditions.

#### Basic conditions [SEC 6(1)]

- His stay in India during the previous year should be at least **182 days**.(OR)
- He has been in india for at least 365 days during the **four years** preceding the previous year **and**
- His stay in India during the previous year should be at least 60 days.

#### Additional conditions [section 6(6)]

- He should be a resident for at least **2 years out of 10 years preceding the previous year**[i.e., he should satisfy any one of the basic conditions for at least 2 years].
- His stay in India in the **7 years preceding** the previous year should be at least **730 days**.

**Note:** first basic condition will only apply if:

- a. An India citizen leaves India for employment outside India.
- b. An Indian citizen leaves India as a member of a crew of Indian ship.
- c. A person who is an Indian citizen or person of Indian origin living outside India comes to visit India.

For any one of the above cases, second basic condition should not be taken for calculation of residential status.

While calculating number of days for stay in India both, day of departure from India and day of arrival in India are to be counted as stay in India.

#### When an Individual is

##### 1. Resident

If an individual satisfies **any one or both of the basic conditions**, then he is said to be a 'resident'.

##### 2. Resident and Ordinarily a Resident [Sec 6(1)]

After fulfillment of **any one or both of the basic condition if an individual fulfills both the additional conditions**, then he is said to be resident and ordinarily a resident.

##### 3. Resident but Not Ordinarily a Resident [Sec 6(6)]

After satisfying **one or both of the basic conditions if an individual satisfies one or none of the additional conditions**, then he is said to be resident but not ordinarily a resident.

##### 4. Non-Resident [Section 2(30)]

If any individual **does not satisfy any one of the basic conditions** then he is said to be a non resident.

#### Important points to be considered while calculating residential status of an individual

- a. The stay need not be for a continuous period.
- b. The stay need not be at a same place.
- c. It means stay any where within Indian geographical region.
- d. If a person is in India only for a part of a day, the number of hours of his stay in India is taken for calculating of residential status. In absence of above information, then the day he enters India and the day he leaves India is to be taken for computation.

- e. A person of India origin means he, or anyone of his parents or anyone of his grandparents should have been born in undivided India.
- f. It is immaterial whether he stays in India for business purposes or on a personal purposes or visits India as a tourist.

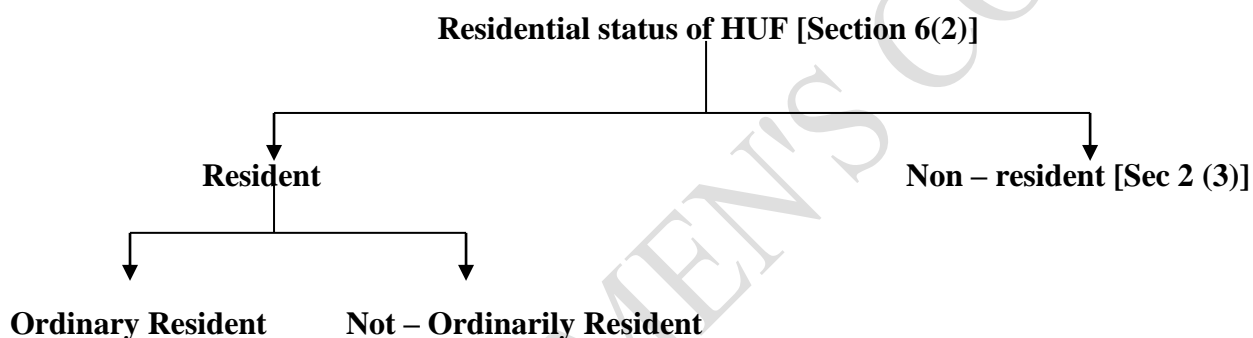
**Summary of conclusion for residential status**

Status	Basic conditions	Additional conditions
Resident	Satisfied	-
Resident and ordinary Resident [OR]	Satisfied	Satisfied
Resident and Not Ordinary Resident [NOR]	Satisfied	Not Satisfied
Non-Resident [NR]	Not Satisfied	-

**Note**

- In case an Indian citizen who goes abroad in the previous year for employment or as a member of the crew of an Indian ship 60 days should be taken as 182 days.
- In case an Indian citizen who stays abroad comes on a visit to India during the previous year 60 days should be taken as 182 days.

**Q: Write short note on residential status of HUF.**



**Residential status of HUF [section 6(2)]**

Like an individual, a HUF can be

**1. Resident**

A HUF is a resident if control and place of management of affairs is wholly or partially in India. Once a HUF is found to be resident then in order to determine whether it is resident and ordinarily resident (or) resident but not ordinarily resident, the residential status of its '**Karta**' is checked.

**2. Resident and Ordinarily Resident [Section 6(2)]**

If the karta satisfies both the additional conditions prescribed for computing residential status of an individual then the HUF is resident and ordinarily resident.

**3. Resident But Not Ordinarily A Resident [Section 6(6) (B)]**

If the Karta fulfills any one or none of the additional conditions prescribed in case of an individual then the HUF is resident but not ordinarily resident. This status is allowed only to HUF along with individuals. A HUF will be 'not ordinarily resident' if

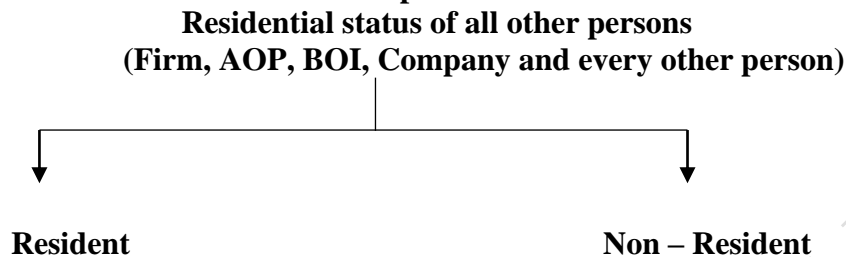
- a. Its manger (Karta) has not been resident in India in nine out of ten previous years preceding the relevant accounting year (**or**)
- b. The manager had not during the seven previous years proceeding the relevant previous year been present in India for a period or periods amounting in all to 730 days.

**4. Non Resident [Section 2(30)]**

A HUF is nonresident if the place of control and management of affairs is situated wholly outside India.

Note: Karta is the oldest male member in a HUF who normally manages and controls the HUF. If the karta manages and controls HUF outside India then the HUF is nonresident.

**Q: Write a note on residential status of all other persons.**



**Residential status of firm and AOP [or] BOI:**

**Ordinary Resident:**

If control or management of such a firm, AOP or BOI was wholly or partially in India during the relevant previous year

**Not Ordinary Resident:**

A firm, AOP or BOI cannot claim status

**Non Resident:**

If control or management of such a firm, AOP, BOI was wholly outside India during relevant previous year.

**Q: How to determine residential status of a company?**

**Residential Status of Company [Sec 6(3)]**

The residential status of a company is to be determined on the basis of its incorporation or registration. Section 6(3) provides the following in this connection.

**Ordinary Resident:**

Every Indian company (i.e. which is incorporated under Indian Law or it is deemed as company under any law of the country) is Resident Company.

In case of any other company which is incorporated outside India but has its control or management in India during relevant previous year it is also a resident company

**Not Ordinary Resident:**

A company cannot enjoy this status

**Non-Resident:**

Any company which is incorporated outside India and has its control and management outside India during relevant previous year is non resident company.

**Q: How to determine residential status of every other person?**

**Residential status of every other person [sec 6 (4)]**

**Ordinary Resident**

In case of every other person, which has its control or management wholly in India during relevant previous year it is resident

**Not Ordinary Resident**

Any other person cannot enjoy this status

**Non-Resident**

Any other person who has control and management wholly outside India during relevant previous year is non resident

## Tax Incidence (Scope of total income)

### Q: What is tax incidence?

The incident of tax depends upon the residential status of a person. based on the residential status of a person, we must determine whether a particular type of income should be taken or left out while calculating his gross total income.

### Q: Explain the scope of total income/Concept of residence and tax liability.

#### Scope of total income of A Resident

- Income received in india
- Income deemed to be received in india
- Income accrued in india
- Income deemed to be accrued in india
- Income received and accrued outside india from business/profession set up in india
- Income received and accrued outside india from business/profession set up outside india
- Any other received and accrued outside india

**Scope of income=Indian income+foreign income**

#### Scope of total income of Not Ordinary Resident

- Income received in india
- Income deemed to be received in india
- Income accrued in india
- Income deemed to be accrued in india
- Income received and accrued outside india from business/profession set up in india
- 

**Scope of income=Indian income+one particular type foreign income**

#### scope of total income Non-Resident

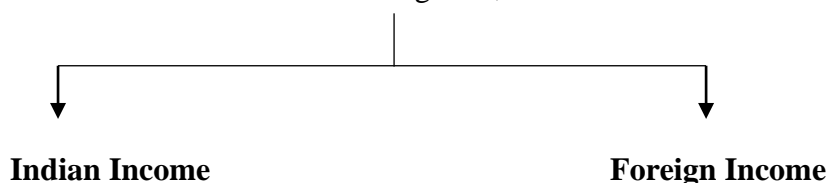
- Income received in india
- Income deemed to be received in india
- Income accrued in india
- Income deemed to be accrued in india

**Scope of income=Indian income**

### Q: Explain the types of income.

#### Types of income

Broadly income can be divided into two categories;



#### A. Indian Income

Indian income is called by various words and names. These are;

- Income earned in India
- Income accrues and arises in India

- Income received or deemed to be received in India
- Income payable in India. Income may have been earned in a foreign country but it is payable in India
- Income earned (or accrues ) in India but it is received or payable outside India

### B. Foreign Income

Following types of income are called foreign income.

- Income earned (or accrues) outside India and also received outside India
- Any income which is not earned or accrues or arises in India.

### Q: Discuss the residence and tax liability/ tax incidence.

#### Residence and tax liability (tax incidence)

Incomes	Whether Taxable or Not		
	OR	NOR	NR
Income received in India whether accrued or arisen in India or outside India	Taxable	Taxable	Taxable
Income deemed to be received in India whether accrued or arisen in India or outside India.	Taxable	Taxable	Taxable
Income accruing or arising in India whether received in India or outside India	Taxable	Taxable	Taxable
Income deemed to accrue or arise in India whether received in India or outside India	Taxable	Taxable	Taxable
Income received and accrued or arisen outside India from a business controlled from or a profession set up in India	Taxable	Taxable	Not Taxable
Income received and accrued or arisen outside India from a business controlled from outside India or a profession setup outside India	Taxable	Not Taxable	Not Taxable
Income received and accrued or arisen outside India from any other source	Taxable	Not Taxable	Not Taxable
Income accrued or arisen and received outside India in earlier years but later on remitted to India during the previous year.	Not Taxable	Not Taxable	Not Taxable

### Q: Enumerate the incomes which do not form part of total income.

#### Incomes which do not form part of total income / exempted income

These incomes do not form part of total income either fully or partially. Section 10 of Income Tax Act has given a long list of incomes which are totally exempt from tax and so these incomes are not included in the gross total income of the assess. In other words, such incomes are totally tax free.

1. Agriculture income [Sec 10(1)]
2. Any sum received from HUF [sec 10(2)]
3. Share of income from firm [sec 10(2A) ]
4. Travel concession to an citizen employee [sec 10 (5) ]
5. Gratuity [sec 10(10) ]
6. Commuted value of pension received [sec 10(10A)]
7. Amount received of leave encashment on retirement [sec 10(10AA) ]
8. Retrenchment compensation paid to workmen [sec 10(10B) ]
9. Payment received under Bhopal Gas Leak Disaster (Processing of claims ) Act 1985 [sec10(10BB) ]
10. Retirement compensation from a public sector company or any other company
11. Income by way of tax on perks [sec 10(7) ]
12. Any sum received under life insurance policy



13. Payment from statutory Provident fund
14. Payment from recognized fund
15. Payment from Superannuation fund
16. House Rent allowance
17. Scholarship
18. Allowance of M.P. / MLA / or MLC [sec 10(17) ]
19. Income of Mutual Funds
20. Dividends by a domestic company

**BOOKS FOR REFERENCE:**

Income tax law & practice-V.P GAUR & D.B NARANG  
Income tax law & practice-T.S REDDY & Y.HARIPRASAD REDDY

**(UNIT-I Completed)**

**UNIT II**  
**Income from Salaries**

**Introduction**

Any person employed gets compensated by way of remuneration for services rendered. This is called 'Salary'. It is received in cash or in kind – by way of amenities, benefits, perquisites. Which emoluments are 'salary' how to value perquisites and what deductions are available from 'salary' has been dealt with under this head of income.

**Q: What do you mean by heads of income?**

**Heads of income**

For the purpose of computation of total income to assess income tax, all incomes have been classified under the following five heads of income:

1. Salaries – Section 15 to 17
2. Income from House property. Sections 22 to 27
3. Profits and Gains of Business or profession – Sections 28 to 44
4. Capital Gains – Sections 45 to 55, and
5. Income from other sources – sections 56 to 59

**Q: Define salary [Sec 17(1)]**

**Definition of salary**

Defined u/s 17 - Inclusive definition - means apart from general and popular meaning, also it includes those items which otherwise may not be considered as salary.

“Salary” includes

- Wages;
- Any annuity or pension;
- Any gratuity
- Any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;
- Any advance of salary;
- Any payment received by an employee in respect of any period of leave not availed of by him;
- The total sum accredited to the credit of employees recognized provident fund to the extent chargeable to tax.
- Transferred balance in a recognized provident fund to the extent it is taxable.

**Q: Enumerate the features of salary?**

**Features of salary**

**1. Employer- Employee Relationship**

A payment can be taxed under 'salaries only' when there is relationship of employer and employee between the payer and payee.

In the absence of such employer-employee relationship, the payment are to be taxed under the head of 'Income From Other Sources'..

## **2. Salaries and business profits**

### **a. Source of income**

Whether remuneration paid to a person is chargeable as his business income or as salary, is a question of fact. If a director works as an employee of the company, payment made to him by way of salary, perquisites, bonus, etc. will be chargeable under 'Salaries'.

### **b. Partners remuneration not chargeable under 'Salaries'**

Any salary, bonus, commission or remuneration received/receivable by a partner from a firm will only be chargeable under "Profits and gains of business or profession" and not under 'Salaries'.

## **3. Salaries and Professional income**

Every profession involves entering into successive engagements and contracts. Each such engagement or contract may also be treated as an employment. If a professional person such as lawyer, a chartered accountant, or a doctor works under a contract of service, remuneration received by him will be chargeable under "Salaries" even if he owes his employment to his profession.

## **4. Voluntary Surrender of Salary:- Real and Fictional**

Salary will become income only after it has fallen due. Surrender salary before it has become due will only be surrender of fictional salary, not liable to tax.

If salaries are payable at the end of the accounting year and if an employee agrees, before the end of the accounting year, to surrender the entire salary, no chargeable salaries will arise and there will be no tax liability.

## **5. Salary from former employer, present employer or prospective employer**

Remuneration received or due during the previous year is chargeable to tax under the head 'Salaries' irrespective of the fact whether it is received from a former, present or prospective employer.

## **6. Personal gifts and other voluntary payments**

An assessee will be taxed under 'salaries' in respect of all payments received from his employer, whether in cash or in kind, under a contract or otherwise, and in addition to salary or in lieu of it.

## **7. Tax-Free Salary**

In the case of a 'tax-free salary', the employee will be liable in respect of gross salary, i.e., the amount of tax paid on his behalf by the employer.

## **8. Gross salary due to the employee**

For the purposes of computing the income taxable under this head, the gross salary due to the employee should be taken as the basis.

## **9. Previous year of Salary income**

The previous year for the income under the head "Salaries" shall always be financial year of the Govt., of India. From the A/Y 1989-90 onwards, P/Y of Salary Income will end on March 31 immediately preceding the A/Y.

## **10. Salary taxable on "due" or "receipt" basis whichever is earlier**

Basis of charge in respect of salary income is provided by Section 15, salary is chargeable to tax either on "Due basis" or on "Receipt basis" whichever matures earlier.

## **Q: Explain the Procedure for Computation of Salary Income or Format for Computation of Taxable Income from Salary**

- **Basic salary**

Both Basic salary and wages means a payment or compensation for work done, or service rendered, except that ordinarily salary is paid in respect of non-manual work and wages, for manual work. Under the grade system basic salary is to be calculated by considering the date of appointment and annual increment.

- **Dearness allowance (DA)**

It is always fully taxable, however inclusion of DA for the purpose of various calculations is depend upon the factor whether it form part of salary for retirement benefits or not. In the absence of specific information, it is assumed that D.A is not forming part of salary.

- **Commission**

It is always fully taxable, however for the purpose of calculations it is to be considered only when it is based on the fixed percentage on sales.

- **Bonus**

Bonus is included in gross salary. It is taxable on receipt basis. While 'contractual bonus' is regarded as salary, 'gratuitous bonus' is taxable as perquisites. If bonus is received in arrears, the assessee can claim relief in terms of section 89(1).

- **Advance salary**

Advance salary is taxable on receipt basis in the assessment year for relevant to the previous year in which it is received. For the purpose of calculations it is not to be considered.

- **Arrear salary**

It is taxable on receipt basis, if it has not been taxed earlier on due basis. Any amount of salary received from present or past employer during relevant previous year and which relates to some earlier previous years, is treated as arrears of salary. It is taxable on receipt basis and for the purpose of calculations it is not to be considered.

**Computation of income from salary of Mr..... For the assessment year 2013-2014**

<b>Salary (sec.15,16 &amp;17)=Basic Salary</b>	<b>+</b>	<b>Allowances</b>	<b>+</b>	<b>Perquisites</b>	<b>+</b>	<b>Profits in lieu of salary</b>
17(1)		17(3)(ii)		17(2)		17(3)
<b>=Total amount - Std.Ded u/s 16 (nil) - professional tax</b>						
<b>=Taxable Salary</b>						

<b>Particulars</b>	<b>Amount</b>
<b>Basic Items</b>	
Basic salary/wages/remuneration/pay	xxx
Special pay	xxx
Bonus[gratuitous/standard]	xxx
Fees	xxx
Commission	xxx
Advance salary	xxx
Arrear salary	xxx
<b>Allowances</b>	
Fully taxable allowance	xxx
Partly taxable/partly exempted allowances	xxx
Fully exempted allowances	Nil
<b>Perquisites</b>	
Taxable for all[specified and unspecified]	xxx
Taxable for specified employees only	xxx
Exempted for all[specified and unspecified]	Nil
<b>Special Items</b>	
Gratuity	xxx
Pension	xxx
Leave encashment	xxx
Provident fund	xxx
<b>Gross Salary</b>	xxx
<b>Deductions u/s 16</b>	
(i) Entertainment allowances	xxx
(ii) Professional/employment tax	xxx
	xxx
<b>Income from Salary</b>	xxx

**Q: Discuss the concept of provident funds under IT act. (Features)**

**Provident fund:**

The word 'provident' means to provide for the future. Hence provident fund is to provide for the future of the employee. This fund is credited by any amount deducted from the salary of the employee every month at a

certain rate and the employer also makes his own contribution to this fund. These contributions are invested to earn interest, which is also credited to the employee's provident fund.

When an employee retires from service, he receives this amount in lump sum along with interest on it. If the employee dies during the tenure his service, the balance in the fund is received by his wife and children or legal heirs.

**Q: What are the types of provident funds?**

**Kinds /types of provident funds**

1. **Statutory Provident Fund (S.P.F):** The statutory provident fund is regulated by the provident funds Act 1952. It applies to employees of the Govt., Semi Govt., local bodies, universities and other recognized educational institutions.

2. **Recognized Provident Fund (R.P.F):** A recognized provident fund is a fund to which the provident fund Act, 1952, applies. It is recognized by the chief commissioner of income tax. Generally, this fund is maintained by scheduled banks, factories and several business houses. Thus, it is usually maintained by private undertakings.

3. **Unrecognized Provident Fund (UR.P.F):** An unrecognized Provident Fund is that provident fund which is neither statutory nor recognized. Any institution or organization can maintain this fund. It is approved by the P.F. Commissioner but not by the commissioner of income tax. This fund is maintained in private sector organizations.

4. **Public Provident Fund (P.P.F):** Public Provident Fund is operated under the public provident fund Act 1968. Membership of this fund is open to every individual though it is especially suited to self employed people. An employee may also contribute to this fund in addition to the fund operated by his employer. An account under his scheme can be opened at a branch of the SBI or its subsidiaries or at a branch of any of the 13 nationalized banks authorized for this purpose by the Central Govt. The contributions made to the scheme with interests are repayable after 15 years.

**Q:Enumerate the taxable income as regards provident funds.**

**Computation of taxable income as regards provident funds.**

Particulars	SPF ( For Govt., Semi Govt employees)	RPF (For private sector )	URPF (For private sector )	PPF ( self employed people)
<b>1.Employee own contribution</b>	Eligible for Deduction U/S 80C	Eligible for Deduction U/S 80C	Not eligible for Deduction U/S 80C	Eligible for Deduction U/S 80C
<b>2.Employer contribution</b>	Fully exempted	Amount exceeding 12% of salary is taxable	Ignore for the time being	Not taxable
<b>3.Interest credited</b>	Fully exempted	Amount exceeding 9.5% of salary is taxable	Ignore for the time being	Fully exempt

**Note: Salary= Basic + DA (if it is forming part of salary) +Commission (if it is fixed percentage on sales)**

**Q: What is meant by allowances?**

**Allowance**

An allowance is a cash payment to the employee on a regular basis in addition to basic salary to meet certain expenses required to be incurred by him in connection with duties of his office, or to compensate him for any expenditure which is owing to performance of his duty in particular circumstances or at a particular place. Allowances may be paid voluntarily or under any contractual obligations.Allowances are generally taxable under section 15 on 'due' or receipt basis and are to be included in the gross salary unless a specific exemption is provided in respect of any such allowances.

**Allowances [sec17(3)]**

<b>Fully exempted</b>	<b>Fully taxable</b>	<b>Partially taxable</b>
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<p>1.Foreign allowance only in case of Government employees posted out side India.</p> <p>2.House rent allowance given tto judges of High court and supreme court</p> <p>3.Sumptuary allowance given to judges of High court and supreme court</p> <p>4.court and supreme court Allowances from U.N.O</p>	<ol style="list-style-type: none"> <li>1. Dearness allowance, Additional Dearness Allowance, High Cost of living allowance.</li> <li>2. City Compensatory Allowance.</li> <li>3. Capital Compensatory Allowance.</li> <li>4. Lunch Allowance.</li> <li>5. Tiffin Allowance</li> <li>6. Marriage Allowance</li> <li>7. Family Allowance</li> <li>8. Deputation Allowance</li> <li>9. Warden ship Allowance</li> <li>10. Non Practicing Allowance</li> <li>11. Project Allowance</li> <li>12. Overtime Allowance</li> <li>13. Fixed Medical Allowance</li> <li>14. Entertainment Allowance</li> <li>15. Water And Electricity Allowance</li> <li>16. Servant Allowance</li> <li>17. Dog allowance</li> </ol>	<ol style="list-style-type: none"> <li>1. House rent allowance.</li> <li>2. Entertainment allowance for government employees.</li> <li>3. Allowances covered U/S 10(14) <ol style="list-style-type: none"> <li>i. Helper Allowance</li> <li>ii. Uniform Allowance</li> <li>iii. Academic Allowance</li> <li>iv. Conveyance Allowance</li> <li>v. Traveling Allowance</li> <li>vi. Any special Allowance in the nature of Composite Hill Compensatory Allowance or High Attitude Allowance or Uncongenial Climate Allowance or Snow Bound Area Allowance or Avlanche Allowance</li> <li>vii. Any Special Compensatory Allowance in the nature of border area or remote area or difficult area or disturbed area Allowance</li> <li>viii. Transport Allowance</li> <li>ix. Tribal Area Allowance</li> <li>x. Running Allowance given to employees of transport sector.</li> <li>xi. Children Education Allowance</li> <li>xii. Hostel Expenditure Allowance</li> <li>xiii. Compensatory Field Area Allowance</li> <li>xiv. Compensatory Modified Field Area Allowance.</li> <li>xv. Special allowance in the nature of counter insurgency allowance given to the members of armed forces operating in the areas away from their permanent locations for a period of more than 30 days.</li> </ol> </li> </ol>
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### Fully Taxable Allowances

All the allowances, which are not discussed above, like dearness allowance, city compensatory allowance, medical allowance etc, are taxable in full.

**Note:** For computing exemptions and deductions from allowances and provident funds, the term salary means Basic + D.A. if it forms part of salary + commission if it is given of a percentage on sales.

D.A. forms part of salary when it is,

1. Given as forms part of salary
  2. Taken into account for the calculation or retirement benefits like P.F., Pension etc.
- (or)
3. Given as dearness pay.
  4. Given as per the terms of employment.
- (or)

### Q: Explain Dearness Allowance.

Dearness allowance is also termed as additional Dearness allowance, or High cost of living allowance or interim relief. These allowances are given by employer to the employees as compensation for rise in prices. Dearness allowances, sometimes, is given under the terms of employment and sometimes without it. Therefore it may be mentioned that:

- a. D.A. enters into pay for service benefits or (DASB)
- b. D.A. enters into pay for retirement benefits or (DARB)
- c. D.A. is given under the terms of employment or
- d. D.A. forms part of salary

e. Dearness pay forms part of salary for super annuation benefits. It is treated as part of salary for certain purposes such as provident fund, value of rent free house, house rent allowance, bonus, gratuity, leave encashment etc.

**Special Allowances Sec. 10 (14)**

<b>Allowance</b>	<b>Amount of exemption</b>
Conveyance or traveling allowances (Expenses on transfer is also to be treated as official purpose)	Amount spent for the performance of official duties.
Helper allowance	Amount spent for the performance of official duties.
Uniform allowance	Amount spent for the performance of official duties.
Academic allowance and research	Amount spent for academic and research purposes.
Travailing / transfer / Daily allowance	Daily expenses incurred due absence from his place of work while on tour or journey in connection with transfer
Allowances to a transport employee to meet his personal expenses while running the vehicle	70% of such allowance or Rs. 6,000/-p.m. whichever is less.
Children education allowance	Actual allowance (or) Rs.100 per month per child whichever is less (subject to a maximum of two children)
Children Hostel allowance	Actual allowance or Rs.300 per month per child whichever is less (subject to a maximum of two children)
Any special allowance in the nature of composite hill compensatory allowance / High altitude allowance / uncongenial climate allowance / snow bound area allowance / Avalanche allowance	Exemption allowed up to Rs. 300 p.m to Rs. 7,000 p.m.
Any special compensatory allowance in the nature of Border area allowance / Remote area allowance / difficult area allowance/ disturbed area allowance.	Exemption allowed up to Rs. 200 p.m to Rs. 1,300 p.m.
Compensatory field area allowance	Exemption allowed up to Rs. 2,600 p.m
Compensatory modified field area allowance	Exemption allowed up to Rs. 1,000 p.m
Counter insurgency allowance / compensatory field area allowance	Exemption allowed up to Rs. 3,900 p.m
Highly active field area allowance	Exemption allowed up to Rs. 4,200 p.m
Underground allowance given to coal mine workers.	Exemption allowed up to Rs. 800 p.m
Island duty allowance given to armed forces posted in Andaman & Nicobar and Lakshdweep group of islands	Exemption allowed up to Rs. 3,250 p.m

Tribal area allowance	Exemption allowed up to Rs. 200 p.m in the states of Madya Pradesh, Tamil nadu, Utter Pradesh, Karnataka, Tripura, Assam, West Bengal, Bihar and Orissa.
Transport allowance for the journey between office and residence.	Actual or Rs.800 per month whichever is less.
Transport allowance to a blind or handicapped employee for the journey between office and residence	Actual or Rs.1,600 per month whichever is less.

**Q: Explain the Entertainment allowance [Sec.16 (ii)]**

**Entertainment Allowance [EA]**

A deduction is allowed to those persons who receive this allowance. Till assessment year 2001 – 02 this deduction was admissible both to Government as well as Private sector employees. But will effect from assessment year 2002 – 03 this deduction is admissible only to Government employees (whether central or state) for an amount equal to least of following:

- |                                                                                                                                                                                 |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>a. Statutory limit Rs. 5000<br/>(or)</li> <li>b. 1/5 of basic salary only<br/>(or)</li> <li>c. Actual Entertainment Allowance</li> </ul> |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

**Q: Explain the HRA u/s 10 (13A).**

**House Rent Allowance [HRA]: Section – 10 (13A)**

The exemption for this allowance will be the lowest of the following.

- |                                                                                                                                                                                                                                                                                                                                                                                                            |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>a. 50% of Salary in case of principal cities and 40% of salary in the case of other cities (or)</li> <li>b. Actual allowance</li> <li>c. Excess of rent paid over 10% of salary.</li> <li>d.</li> </ul> <p style="text-align: center;"><b>Principal :cities Chennai, Mumbai, Delhi and Calcutta</b><br/><b>Taxable HRA=actual HRA received –exempted amount</b></p> |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

**Q: Explain the Perquisites the following cases (a) Taxable in all cases (b) Fully exempted (c) Taxable in specified cases only:**

**Perquisites [Sec. 17 (2)]**

It is given by an employer to his employee in addition to his regular remuneration. It may be in goods or services or amenities or indirect cash payments etc like allowance, it will not be paid periodically in fixed amount. The employees will get this benefit only when they enjoy it.

Under the new rules, the perquisites provided not only to the employee but also to any member of his household shall be considered for tax purposes. ‘Member of household’ means

1. Spouse
2. Children and their houses
3. Parents
4. Servants and dependants

**Perquisites**

(If the employer is subject to Fringe Benefit Fax)

A. Taxable in all cases

B. Fully exempted

C. Taxable in specified cases only

**A. Perquisites Taxable in all cases**

The following three perquisites, if given in the problem, are to be valued and included in the taxable income of all assesses.

<b>i. Rent – free Accommodation</b>		
Value of unfurnished Accommodation		Value of furnished Accommodation
<b>Government employees</b>		
As per Government rules		Value of unfurnished house + 10% of the cost of furniture (or) hire charges if obtained on hire.
<b>Non – Government Employees</b>		
1. Accommodation is owned by the employer and provided to the employee.		
<b>Cities having population</b>		
<b>Exceeding 25 lakhs</b>	<b>10 lakhs to 25 lakhs</b>	<b>Upto 10 lakhs</b>
15% of salary	10% of salary	7.5 % of salary
ii. Accommodations is taken on lease or rent by the employer and provided to the employee.		
20% of salary (or) actual lease or rent (WEL)		
iii. Accommodation provided at the new place while retaining the accommodation at the old place in case of transfer of an employee :		
<b>Upto 90 days</b>	<b>After 90 days</b>	
Value of only one accommodation which has the lower value	Value of both accommodations.	
iv. Accommodation provided on a hotel		
Upto 15 days on account of transfer	Other cases	
Nil	24% of salary or actual charges paid by the employer whichever is less.	
2. If Residential Accommodation is provided at concessional Rent (Concessional Accommodation)		
Taxable value of concession = Value of accommodation as per the above rules – rent paid by the employee		

Same as above.

**3. Other taxable perquisites in all cases**

For all the following perquisites, the value will be actual amount spent by the employer :  
Any payment made by the employer on behalf of an employee like Life Insurance premium (or) annuity contributions or other bills in the name of employee paid by the employer.



However, payments made to a scheme under which the benefits may or may not arise in future are not perquisites. Example : Group Insurance Schemes, similarly, employer's contribution to the provident fund account of an employee is not a perquisite.

**Any of the following Fringe benefits / amenities.**

Nature of benefit / amenity	Value of perquisite	
a. i. Interest free or concessional loan exceeding Rs.20,000.	Interest at the rate prescribed by the SBI on 1.4.2007 in case of free loan or concession over this rate.	
ii. Loan for medical treatment for specified diseases excluding the amount reimbursed under medical insurance.	Note taxable.	
b. Use of employer's movable assets other than computer / laptop or motor car i. Owned by the employer ii. Hired by the employer	10% of cost Actual hire charges	
c. Movable assets sold by an employer to his employee at concessional price	Actual cost minus depreciation at the following rates for each completed year of use by the employer.	
	<b>Assets</b>	<b>Rates</b>
	Electronic and computer items	50% of W.D.V.
	Motor car	20% of W.D.V.
	Any other asset	10% of cost.

**B. Fully exempted or Tax Free perquisites**

- a. Group Medical insurance i.e. , Mediclaim premium paid or reimbursed by the employer
- b. Any reasonable expenses incurred by the employer for the medical treatment to the employee or his family in his own hospital or in a recognized public hospital in India.
- c. In any other hospital in India, Actual (or) 15,000/- p.a. (WEL) iv. Medical treatment outside India for the employee or any member of the family;
- d. Cost of treatment and stay abroad with one attendant; It is exempted to the extent permitted by the RBI.
- e. Cost of travel with one attendant; It is fully exempted if the GTI of the employee before including does not exceed Rs.2,00,000.
- f. Tea or snacks or free food or beverages provided in work place or through paid vouchers.
- g. Recreational facilities like club, health club and similar facilities.
- h. Amount spent on training (or) refresher courses of employees.
- i. Free Telephone including phone.
- j. Goods (manufactured by the employer) sold as concessional rate of the employees.
- k. Perquisites allowed by the Indian Government to its employee outside India, who is a citizen of India.
- l. Sum paid by an employer to Staff Group Insurance Scheme.
- m. Motor Car facility.
- n. Rent free official residence and conveyance facility provided to a judge of High Court or Supreme Court.
- o. Rent free furnished residence and maintenance thereof to an official of parliament or a union minister or a leader of opposition in parliament.
- p. Conveyance facility to cover the journey between office and residence.
- q. Allotment of shares, debentures or warrants at free of cost or at a concessional rate by a company to its employees.
- r. Interest free loan or concessional loan of an amount not exceeding Rs. 20,000.

- s. Scholarships to employees or their children.
- t. Gift in kind.
- u. Computer / laptop given to an employee for personal / official use.
- v. Free education to the employee's children in the institution owned or maintained by the employer provided the cost of education does not exceed Rs.1000 pm per child without restriction on the number of children.
- w. Free transfer of movable assets except computer, electronic items and car to an employee by the employee by the employer after using it for 10 years or more.
- x. Guest house or holiday home facility provided
- y. 21. Leave Travel concession: It is exempted subject to the following conditions
- z. It must be given for the employee and his family to proceed on leave to any place in India.
- aa. The exemption should not exceed the actual expenditure for the shortest route.
- bb. Periodicals and journals required for discharge or work.
- cc. Tax on perquisite – in – kind paid by the employer.
- dd. Free ration armed
- ee. Free transport facility.

### C. Perquisites Taxable in specified cases only

- a. Director of a company
- b. A person holiday 20% or more equity shares in a company i.e. he has a substantial interest in the company.
- c. An employee whose salary income exceeds Rs. 50,000/-.

#### 1. Free gas, electricity and water supply

a. Where the supply is from employer's own sources	Manufacturing cost per unit incurred by the employer
b. Where the supply is from the purchases made by the employer from outside agencies.	Actual expenses incurred by the employer.

#### 2. Free domestic servants

a. Sweeper, watchmen gardener (or) personal attendant	Actual cost to employer
b. If gardener is provided with aren't free or concessional accommodation owned by the employer	Not taxable separately.

### Motor Car

#### A. Motor car is owned or hired by employer and its running and maintenance expenses are met or reimbursed by employer

1. Car is fully used in the performance of official duties of the employee:

<b>Value of Perk = Nil</b>
----------------------------

2. Car is fully used for the private, personal or family purposes of the employee:

#### Value of Perk

Actual expenses incurred by the employer on running and maintenance of car	<b>XXX</b>
Add: Salary of chauffer	<b>XXX</b>
Normal wear and tear of car (10% of actual cost)	<b>XXX</b>
Less: any amount paid or re-imbursed by employee	<b>XXX</b>
<b>Value of Perk</b>	<b>XXX</b>

3. Car is used partly in the performance of duties and partly for private or personal purposes:

Where the car is owned by the employer and expenses are met by him.	Upto 16 H.P.	More than 16 H.P.
	Rs.1,800 pm + Rs.600 p.m. • Rs.900 p.m. driver salary	Rs.2,400 + Rs.900/-p.m • Rs.900 p.m. driver salary

**B. Car is owned by employee but its running and maintenance expenses are met or reimbursed by employer:**

1. Car is fully used in the performance of official duties of the employee:

- No value to be taxed but proper log book for official purposes.

2. Car is being used partly for official purposes and partly for personal or private purposes:

Where the car is owned by the employer and expenses are met by him.	Upto 16 H.P.	More than 16 H.P.
	Rs.1,800 pm + Rs.600 p.m. • Rs.900 p.m. driver salary	Rs.2,400 + Rs.900/-p.m • Rs.900 p.m. driver salary

**Note:** A proper log book must be maintained

**C. Where the employee owns any other automotive conveyance but the actual running and maintenance expensive are met or reimbursed by the employer**

1. Car is fully used in the performance of official duties of the employee:

- No value to be taxed but proper log book for official purposes.

2. Car is being used partly for official purposes and partly for personal or private purposes:

Where the car is owned by the employer and expenses are met by him.	Upto 16 H.P.	More than 16 H.P.
	Rs.1,800 pm + Rs.600 p.m. • Rs.900 p.m. driver salary	Rs.2,400 + Rs.900/-p.m • Rs.900 p.m. driver salary

**Note:** A proper log book must be maintained

**Other Points**

1. **Free use of car between office and residence:** Use of employer's car to go the place of employee's work and come back to his residence is not a taxable perk and hence it is ignored.
2. **Conveyance facility to high court and Supreme Court judges:** It is fully exempted.
3. **Meaning of Month:** Month means a complete calendar month and if there is a part of the month, the same shall be ignored.

**Q: Explain the other items included in Salary/Retirement Benefits. (a) Pension (b) Gratuity (c) Earned Leave and (d) Profits in lieu of Salary.**

**Other items included in Salary/Retirement Benefits**

- A. Pension
- B. Gratuity
- C. Leave salary encashment at the time of retirement

**Family Pension**

The family pension received after the death of an employee is taxable under the head "Income from other source" in the hands of recipient.

**Gratuity**



Government employees

Non – Government employees.

Fully exempted

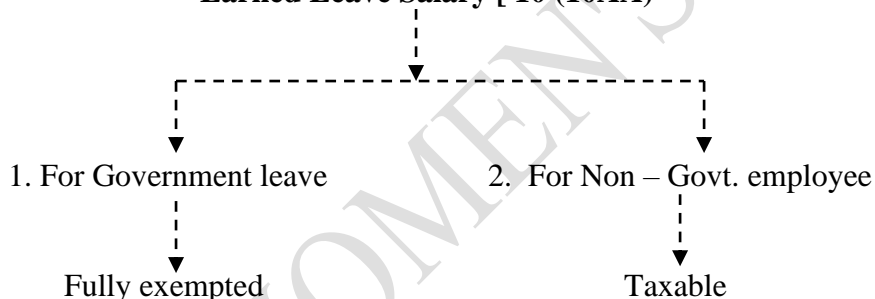
1. Employees covered  
By the payment of  
Gratuity Act 1972.

2. Employees not  
covered by the  
payment of  
Gratuity Act 1972.

<b>1</b>	<b>2</b>
<b>Lowest of the following is exempted</b>	<b>Lowest of the following is exempted</b>
1. '15 days' salary for every completed year of service or part there of exceeding six months	1. Half a month's average salary for each year of completed service.
2. Rs. 3,50,000.	2. Rs. 3,50,000.
3. Actual gratuity	3. Actual gratuity
Note : Salary per day = Basic + DA last drawn ----- 26	Note : Average salary is the average of the salary (taken for the computation of allowances) drawn in the 10 months immediately preceding the month in which the employee retires.

**C. Earned Leave salary encashed at the time of retirement (or) Superannuation:**

**Earned Leave Salary [ 10 (10AA)**



2. For Non – Government employee  
The lowest of the following is exempted
  - a. Leave salary (Average) for the unutilized entitled leave period.  
(or)
  - b. Ten months average salary (it means average of the 10 months salaries drawn immediately preceding the retirement).  
(or)
  - c. Rs.3,00,000.  
(or)
  - d. Amount of Leave encashment actually received

Note :

1. Unutilized entitled leave period = Actual leave period for the total service or 30 days for every year of actual service whichever is less minus period already utilized.
2. Salary = Basic + D.A., if it forms part of salary + Commission if it is given as a % of sales.

**Profits in lieu of salary – Section – 17 (3)**

1. Compensation for loss of employment: Any compensation received by an employee upon termination of his services or upon the modification of the terms and conditions of employment is taxable subject to the following exemptions.
  - i. Compensation under the scheme Central Govt. Fully exempt.
  - ii. Compensation under any industrial disputes Act : Lowest of the following is exempted.

- a. Amount of compensation as per the industrial disputes Act (i.e 15 days average salary pay for every year of completed service or part of thereof in excess of six months)
    - (or)
  - b. Rs.5,00,000
    - (or)
  - c. Amount received
2. Any payment due or received by an assessee from his employer except the following:
- i. Exempted gratuity
  - ii. Exempted H.R.A.
  - iii. Exempted commuted pension
  - iv. Exempted retrenchment compensation
  - v. Payment from an approved superannuation fund, statutory provident fund.
  - vi. Payment from recognized provident fund to the extent it is exempted.
3. Any payment from unrecognized provident fund or such other fund to the extent, it is not relating to the contributions made by the assessee or interest thereon.
4. Any sum received under a Keyman Insurance Policy.
5. Any amount received prior to employment or after cessation of employment.

**Compensation received at the time of voluntary retirement.**

It is exempted if it is received under a scheme of voluntary retirement, framed in accordance with the guidelines prescribed in rule 2BA of the income – tax rules. The amount of exemption will be the lowest of the following.

1. Maximum Rs.5,00,000.
2. Actual compensation received
3. Three months salary for every year of completed service.
4. Salary for the remaining months of service before the date of his retirement on Superannuation.

Note: Salary means the salary taken for the computation of allowances. But it is the last drawn salary.

**Q: Explain Deductions from Salary income.**

**1. Standard Deduction Section 16 (i)**

It is not allowed with effect from the assessment year 2006 – 07.

**2. Entertainment allowances: [16 (ii)]**

**3. Tax on Employment [Sec. 16 (iii)]**

In case any sum is paid by the assessee on account of a tax on employment with the meaning of clause (2) of article 276 of the constitution leviable by or under any law, such amount shall be fully allowed as deduction. The example of this tax is professional tax levied by any State Government.

**Q: Explain the Rebate of Tax.**

**Tax Rebate/Rebate of Tax (Section 88)**

To encourage savings, a rebate of tax for contributions towards provident funds (including Superannuation funds), payment of life insurance premium and depositing of money in the post office under Cumulative Time Deposit (CTD) Scheme etc. are allowed from total tax.

**Qualifying amount (Q.A) for Rebate of tax:**

1. Provident fund – Employee’s own contribution to
2. Life insurance premium
3. Group Insurance premium
4. Unit Linked Insurance plan of U.T.I and LIC

5. Cumulative Time Deposit (C.T.D)
6. National Savings Certificate (VIII issue)
7. Any sum paid by an employee in an approved Super annuation fund, during the previous year.
8. Repayment of House Building Advance
9. Amount paid in any scheme of National Housing Bank
10. Any subscription to any deposit scheme of
11. Jeevan Dhara (or) Jeevan Akshay Policy
12. Any amount invested in notified units of UTI
13. Any amount invested in notified deposits scheme
14. Any amount deposited in pension funds
15. Any amount paid as tuition fees
16. Any amount subscribed under Home deposit Account
17. Amount paid as subscription to equity shares of debentures of any eligible issue.
18. Amount paid as subscription any units of any mutual fund.

**Limited of total savings (Qualifying amount)**

1. In case of making savings in point (i) to point (xvi) above can save upto Rs. 70,000.
2. In case of those persons who have made savings under point (i) to (xvi) above and also in point (xvii) or point (xviii) above, such persons can save upto Rs. 1,00,000.
3. Total amount of savings cannot exceed total income of the assessee.

**Rate of Rebate of tax u/s 88**

1. If Gross total Income of an individual or HUF does not exceed Rs. 1,50,000, Rebate shall be allowed @ 20% of qualifying amount.
2. If Gross Total Income of an individual or HUF exceeds Rs. 1,50,000 but does not exceed Rs. 5,00,000, rebate shall be allowed @ 15% of qualifying amount.
3. If Gross Total Income of an individual or HUF exceeds Rs. 5,00,000 – No rebate shall be allowed.

**Q: Explain the relief of income tax u/s 89.**

**Relief of Income Tax (Sec.89 (i) and Rule 21 A**

Where an assessee receives arrears of salary or advance salary in any one financial year besides his regular salary for 12 months and thereby his income is taxed at a higher rate than that at which it would have otherwise been taxed, the Assessing Officer, shall, on an application received from the assessee, grant such relief as prescribed by Rule 21A.

1. Relief in respect of Salary paid in arrears or in advance.
2. Find out the tax on the total income as (including arrears or advance salary) of the PY.
3. Find out the tax on the total income as reduced by the arrears or advance salary.
4. From the amount – arrived at in (i) deduct amount arrived at in (ii)
5. The resultant figure arrived at in (iii) is the tax on additional salary or arrears / advance salary.
6. Ascertain the previous years to which the arrears etc. relate and add the respective amount of arrears in respective previous year.
7. Find out the tax on the total income as arrived at in (v) in respect of each of such PY.
8. Find out the tax on total income (without adding the arrears, etc.) of each of the said PY.
9. From the amount arrived at in (vi), deduct the amount arrived at in (vii)
10. The resultant figure arrived at in (viii) is the tax on arrears, etc.  
Find out the difference between (iv) and (ix). This will be the relief u/s 89 (i).

**BOOKS FOR REFERENCE:**

**Income tax law & practice-V.P GAUR & D.B NARANG**

**Income tax law & practice-T.S REDDY & Y.HARIPRASAD REDDY (UNIT-II Completed)**

**UNIT-III**  
**Income from House Property (IFHP)**

**Q: Give the meaning of IFHP.**

**Meaning of IFHP:**

Income from houses, buildings, bungalows, and godowns are taxed under this head. Under this head, tax is not based upon the actual income; it is based upon the annual value .i.e. Notional value-imaginary value. Annual value of the building and the land attached to the vicinity of the building will be considered for tax under this head.

**Q: Define IFHP.**

According to the Section 22 of IT Act “The annual value of property consisting of any building or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income tax, shall be chargeable to income tax under the head ‘Income from House Property’”.

**Q: Explain the meaning of (a) unrealized rent (b) unrealized rent recovery (c) arrear rent (d) composite rent (e) standard rent (f) actual rent (g) sub-letting .**

1. **Unrealized rent:** The rent which the owner could not realize from the tenant, for the let out period. The unrealized rent is reduced from actual rent receivable in the previous year.
2. **Unrealized rent recovery:** As per Section 25AA, when the assessee realizes any rent which was unrealizable in earlier years (and allowed as deduction), the amount so realized shall be deemed to be income chargeable under the head “income from house property’ in the year in which such rent is realized irrespective of whether or not the assessee is the owner of the property in that previous year.
3. **Arrear rent:** The amount of arrears of rent is taxable in the previous year in which such rent is received after deducting the statutory deduction at 30% of such amount. The income is to be included with the property income.
4. **Composite rent:** Composite rent refers to the total amount received by the owner towards rent of the property and charges for different services provided, such as lift, security ,air – conditioner, etc.  
Composite Rent = Property Rent + Rent for previous provided
5. **Standard rent:** The rent fixed under Rent control Act, where so ever applicable, is called Standard rent.
6. **Actual rent:** It is the rent actually received by the owner of the house property from the tenant.

<b>Given actual rent</b>		<b>XXX</b>
<b>less: period of vacancy</b>	<b>XXX</b>	
<b>Unrealized rent</b>	<b>XXX</b>	<b>XXX</b>
<b>Actual rent</b>		<b>XXX</b>

**7. Sub letting**

When main tenant lets out full or part of the hired building to another person, it is called Sub – Letting, Income from sub – letting, if any, is taxable under the head Income from other sources and not under the head House property. Out of actual rent received, actual expenses relating to sub – let portion are allowed to be deducted.

**Q: What are all the essential conditions required for basis of chargeability.**

- a. The property must consist of buildings and lands appurtenant thereto.
- b. Assessee is the owner of the property.
- c. Assessee does not use the property for purposes of own business or profession.
- d. If a person lets out any house property for smooth conduct of his business/profession, the rental income from such house property shall not be treated as house property income rather it shall be treated as income under the head business/profession. E.g. Quarters let out to the employees of assessee’s own business.
- e. In case of a legal dispute about ownership, generally the person who is presently in receipt of income from such property is liable to tax.

- f. Income from sub-letting is not taxed under the head “Income from House Property”.

**Q: What do you mean by deemed owner of house property?**

**Deemed Owner:**

• **An assessee transferring property to spouse or minor child:**

If an individual transfer any house property to his/her spouse, or Minor child (excluding a minor but married daughter), and if such transfer is without adequate consideration (in the case of spouse or child) or without an agreement to live apart (in the case spouse). He/She (the transferor) will be deemed to be owner of the house property so transferred.

• **Holder of impartible estate:**

An impartible estate is owned by a joint family. But income arising from it will be solely an absolutely to the holder thereof, i.e., the karta, who will therefore be owner of all properties comprised in the estate.

• **Member of Co-operative society, company or association:**

Where the whole or part of a building is allotted or leased to a member under a house building scheme of any society, company, etc., he will be deemed to be owner of the building or part thereof.

• **Person having possession of building under a power of attorney:**

If a person is allowed to take or retain possession of the whole or a part of any building under a power of attorney, such person will be deemed to be owner of such building or part thereof.

• **Assessee acquiring right in respect of Building:**

If a person acquires any right with respect to the whole or a part of a building under the circumstances referred as sale, exchange or lease for 12 years or more, he will be deemed to be owner of such building or part thereof.

**Q: What are all the exempted incomes from house property?**

**Exempted incomes from house property**

- Income from farm house.
- Annual value of any one palace of an Ex-ruler.
- Property income for a local authority.
- Property income of an authority constituted for the purpose of planning, development or improvement of cities and villages.
- Property income of an approved scientific research association.
- Property income of a games association.
- Property income of an educational association.
- Property income of trade unions.
- Property income of a political party.
- Property used for own business or profession.
- One self occupied property.
- Income derived from lending of Godowns or warehouses for marketing of commodities.
- House property held for charitable purposes.

**Q: How do you calculate or compute income from house property?**

**1. Let – Out House properties / Let out House (L/O)**

It refers to the house, which has been let out by the owner or to the tenant. There is no restriction as to how many houses can be let out. Owner can claim all deductions. There is no restriction on the amount of deduction that can be claimed. Municipal tax, standard deduction and interest on borrowed capital are the deductions which can be claimed by the owner.

**2. Deemed to be let out house properties:**

If an assessee being owner of more than one property, occupies more than one house for his residence, then one house of assessee’s choice is treated as self-occupied(house of greater annual value) and the other



houses are treated as 'Deemed to be let out'. This type of house has the same tax treatment like let out houses.

## II. Self – occupied House Properties / Self – Occupied House (S/O)

Self – Occupied house refers to the house, which has been occupied by the owner himself. The owner can claim 'Nil' Gross Annual Value for one self – occupied house. It is not necessary that the owner should occupy only one house. He can occupy more than one house. But for tax purposes only one house will be considered as self – occupied. The choice of identifying self – occupied house is left to the discretion of the owner. Usually, the house that has high Gross Annual Value, will be borrowed capital are the deductions which can be claimed by the owner.

Net Annual value	Nil
Less : Interest on money borrowed for construction, repair Or acquisition of house property max Rs.30,000 or Actual interest WEL	XXX
<b>Loss from HP</b>	<b>(- ) XXX</b>

### Q: Define The Annual Value.

#### Annual value [Sec. 23(1)]

For the purpose of Section 22, the annual value of any property shall be deemed to be

1. The sum for which the property might reasonably be expected to be let from year to year; **OR**
2. Where the property or any part of property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable;  
**OR**
3. Where the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (a), the amount so received or receivable.

### Q: What do you mean by Gross Annual Value?

The annual value is based on expected rent and actual rent. Expected rent is deemed to be the sum for which the property might reasonable be expected to be let out .It is something like notional rent which could have been derived, had the property being let out. Even if the property is neither let-out nor self occupied there will be annual value of the house property taxable under this head. It is otherwise called as Gross Annual Value

### Q: What do you mean by net annual value?

It is the amount available after deducting municipal tax or local tax paid by the owner from the gross annual value. It acts as a base to calculate standard deduction u/s 24.

### Q: Explain the terms Municipal Rental Value and rental value / fair rental value.

#### Municipal value:

In order to levy local taxes the Municipal corporation/committee (i.e.,) local authority conducts a periodical survey of the house properties in their local limits. Based on the survey the rental values are fixed which serves as the basis for levying tax. The rental value so fixed is called Municipal Rental value (MRV).

#### Fair rental Value:

It is the rental value which a house property can fetch based on the rent prevailing for similar type of accommodation in same locality. It is based on the presumption that rent prevailing in same locality for similar properties is almost the same which is called Fair Rental Value(FRV).

### Q: Explain the determination of annual value of house property in different situations.

#### 1. House property let out throughout the year

**Step I**-compare the municipal value and fair rent and take the amount which ever is less

**Step II**- Limit the amount as per step 1 to Standard rent under rent control act, if applicable to the area. The resultant amount is Expected Rent (ER).

**Step III-** Compare expected rent with actual rent and determine the higher value. The resultant amount is Gross Annual Value.

**Step IV-** From GAV deduct municipal taxes actually paid by the owner of the house, the resultant answer is Net Annual Value.

**2. House property let out throughout the year and there is unrealized rent**

**Step I-** Compare the municipal value and fair rent and take the amount WEH.

**Step II-** Limit the amount as per step 1 to Standard rent under rent control act, if applicable to the area. The resultant amount is Expected Rent (ER).

**Step III-** Compare expected rent with actual rent (Which is calculated by deducting unrealized rent from rent receivable) and determine the Higher value. The resultant amount is Gross Annual Value.

**Step IV-** From GAV deduct municipal taxes actually paid by the owner of the house, the resultant answer is Net Annual Value.

**3. House property let out but remained vacant for part of the year.**

**Step I-** Determine actual rent on the basis of number of months actually occupied by the tenant. This is taken as Gross annual value.

**Step II-** From GAV deduct municipal taxes actually paid by the owner of the house, the resultant answer is Net Annual Value.

**4. House property let out with unrealised rent and vacant for the part of the year.**

**Step I-** Determine actual rent on the basis of number of months actually occupied by the tenant and then deduct unrealized rent. This is taken as Gross annual value.

**Step II-** From GAV deduct municipal taxes actually paid by the owner of the house, the resultant answer is Net Annual Value.

**5. House property self occupied for residence.**

**Annual value is taken as Nil.**

**6. More than one house property used for self occupation.**

When more than one house is self occupied by the assessee for residential purposes, only one house is treated as self occupied and all other houses will be deemed to be let out. The house property of higher Gross annual value is to be treated as self occupied. The annual value of the deemed to be let out house property is to be calculated on the basis of the provisions applicable to the let out house.

**7. Part of the house property self occupied and another part of the house property is let out.**

If units are inseparable and it is treated as one house then no benefit of self occupation shall be allowed.

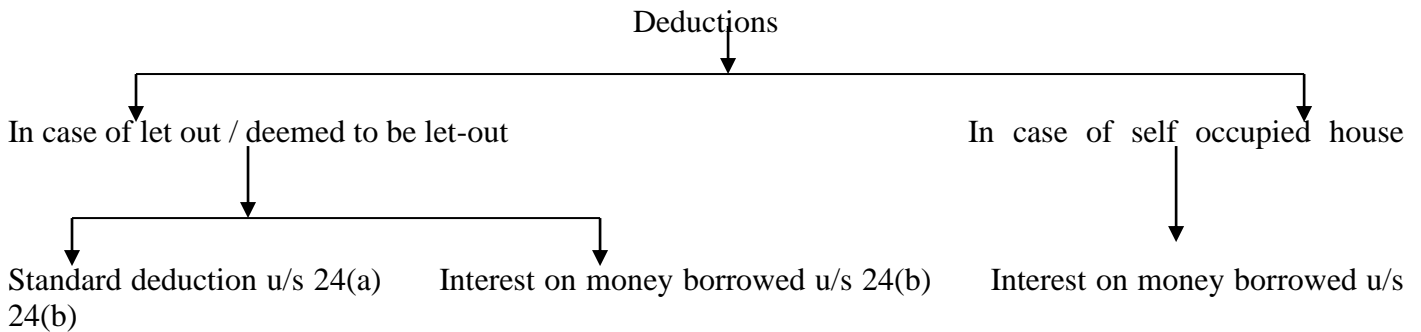
If units are separable each unit or part is to be treated as a separate house and it shall get respective treatment.

**8. House property self occupied part of the year and let out part of the year.**

Whole property is treated as let out house property and no benefit of self occupancy shall be allowed. But actual rent is taken only for number of months house property is actually let-out.

**Q: What are all the deductions from income form the house property u/s 24?**

While calculating house property income, deductions are allowed out of net annual value (NAV). These deductions are as follows.



### 1. Standard deduction [section 24(a)]

**In case of let out /deemed to be let out House**

**S.D = 30% OF NAV**

**In case of self occupied house: S.D = NIL**

### 2. Interest on housing loan/ interest on borrowed capital [section 24(b)]

Housing loan means loan taken /amount borrowed for purchase, construction, repairs or renovation etc of house property. Interest paid / payable on housing loan is allowed as deduction while computing house property income.

#### Tax treatment of interest on housing loan/Interest on borrowed capital

**Interest for the previous year:** Where the house property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital is allowed as a deduction every year.

#### Interest on preconstruction period

If there is pre – completion interest current previous year interest	XXX
ADD L 1/5 <sup>th</sup> of the pre – completion interest	XXX
	-----
	XXX
	-----

#### Note

- a. Interest on pre – construction or completion is allowed as deduction in 5 equal instalments form the PY in which the property is acquired or constructed.
- b. The first installment is deductible in the year in which the construction of the property is completed or in which the property is acquired.

#### Interest on loan in respect of let out house

As far as let out house property is concerned, there is no maximum limit, for the deduction on account of interest on loan including interest on pre- construction period.

#### Interest on loan for self occupied house

In the case of self occupied house the interest on loan is allowed subject to the following limits.

- Where the loan is borrowed for the purpose of construction or acquisition before 1-4-99 up to Rs 30,000
- Where the loan is borrowed for the purpose of construction or acquisition after 1-4-99 up to Rs 1,50,000  
The construction or acquisition is completed with in 3 years the end of the financial year in which capital was borrowed.  
If it is not completed within 3 years interest on loan is allowed as deduction upto a maximum of Rs.30000
- Where the loan is is borrowed for repairs or renewal or construction whether before or after 1-4-99 up to Rs.30000

#### BOOKS FOR REFERENCE:

Income tax law & practice-V.P GAUR & D.B NARANG

Income tax law & practice-T.S REDDY & Y.HARIPRASAD REDDY

**(UNIT-III Completed)**

**UNIT IV**  
**Income from business or profession**  
**Section 28 to 44**

**Q: What is meant by Business?**

**Meaning of Business:**

Business simply means any economic activity carried on for earning profits. Section 2(13) has defined the term as “any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture”.

Business connotes some activity which is carried on by devoting time, attention and labour of a person either by himself or through others normally with a motive to make profit. Production of goods by conversion of raw materials, trading in goods to earn profits and rendering services to others are various forms of “Business”.

**Q: Define the following terms a) Business, b) Profession, c) Vocation.**

**Business [sec. 2(13)]**

It simply means any economic activity carried on for earning profits. Sec 2(3) has defined the term as “any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture.”

**Profession**

A profession is an occupation requiring purely intellectual skills or manual skill controlled by the intellectual skill of the operator. E.g Lawyers, Accountant, Engineer, surgeon, Author etc. So profession refers to those activities where the livelihood is earned by the persons through their intellectual or manual skill.

Sec 2(36) defines ‘Profession’ to include Vocation. The word ‘Profession’ implies professed attainments and special knowledge as distinguished from mere skill.

**Vocation**

It implies natural ability of a person some particular work. The term “Vocation” is expressed differently in different case laws, but all falling under the ordinary and accepted use of the word profession. Tax experts, journalists, architects, cost accountants and a management accountant comes under this category.

**Q: Explain the different methods of accounting.**

The income tax authorities accept the following methods of accounting.

**1. Cash method**

Entries in the books are made when money is actually received or actually paid. No account is maintained for outstanding, prepaid, accrued or unearned incomes.

**2. Mercantile system**

Under this system any income which relates to the current year whether it is received or not, and any expenses whether actually paid or not is taken in to consideration for computing the profits and losses of the business.

**Q: Explain the tax treatment of valuation of stock.**

**Valuation of stock**

Stock is valued according to the general principles of accounting. Generally the valuation of stock in hand is done on the basis of cost or market price WEL. The assessee is free to adopt any method, but once a method is adopted it has to be adhered to from year to year.

**Under or over valuation of stock**

The stocks may be either under valued or over valued. In such cases the profits of the year if affected. To eliminate effect of such valuation correct value of the stock should be found by the following procedures.

$$\text{Correct value in case of under valuation} = \text{Value of stock} \times \frac{100}{(100 - \text{Rate of under valuation})}$$

**Correct value in case of Over valuation** = Value of stock x  $\frac{100}{(100 + \text{rate of under valuation})}$

**Q: Explain the incomes which are chargeable to income tax under the head ‘profits and gains of business or profession’ under Sec 28.**

The scope of income chargeable to tax under the head “Profits and gains of business or profession” is covered by Sec 28 of the act which lays down that the following income must be charged to tax under this head.

- a. Profits and gains Sec 28(i)
- b. Compensation or other payment due to or received by persons in connection with business or profession Sec 28(ii)
- c. Income of any trade or professional or similar association Sec 28(iii)
- d. Profit on sale of license [Sec 28(iii)a]
- e. Cash assistance [Sec 28(iii)b]
- f. Duty drawback of customs or excise [Sec 28(iii)c]
- g. Value of any benefit or perquisite Sec 28(iv)
- h. Salary, bonus, commission or remuneration and interest received by a partner from a firm. Sec 28(v)
- i. Amount received under Keyman Insurance policy Sec 28(vi)
- j. Receipts in nature of ‘non compete fees’ and ‘exclusively rights’
- k. Speculation business
- l. Profit earned from an illegal business.

**Q: What is all the admissible deductions u/s 30 to 37?**

**Deductions: Common Deductions – U/S (30 – 35)**

**A. Rent, Rates, Taxes, Repairs and Insurance in the case of Building premises (Sec.30)**

Deduction is allowed regarding rent, rates, taxes, repairs and insurance premium paid for the building premises where the assessee is carrying on his own business or profession.

**B. Repairs and Insurance of Machinery, Plant and furniture (Sec. 31)**

The following deductions shall be allowed in respect of repairs and insurance of machinery, plant and furniture used for the purposes of the business or profession.

- a. The amount paid on account of current repairs thereto.
- b. The amount of any premium paid in respect of insurance against the risk of damage or destruction thereto.

**C. Depreciation on Fixed Assets (Sec.32)**

Depreciation on the fixed assets is very important item of deduction of any business.

**D. Tea/coffee/rubber development account (Sec .33 AB)**

The deduction will be available to any assessee carrying on the business of growing and manufacturing tea in India.

**E. Expenditure incurred in the field of scientific research Sec 35**

Section 43 (4) defines the scientific research as activities for the extension of knowledge in the fields of natural or applied science agriculture, animal husbandry or fisheries. References to expenditure incurred on scientific research include all expenditure incurred for the prosecution, or the provision of facilities for perusing the scientific research, but does not include any expenditure incurred on the acquisition of rights in or arising out of scientific research.

In respect of expenditure on scientific research the following deductions shall be allowed

Particulars	Amount allowed as deduction
1. Revenue expenditure for assessee himself	Full
2. Contribution to approved scientific research association, payment to an approved	175% is allowed

university, college or institution for scientific research <b>3. Contribution to “National laboratory”</b>  <b>4. Capital expenditure</b> i) On plant, machinery, equipment, building ii) On land (acquisition)  <b>5. In case any capital expenditure (not being expenditure on land and building) is incurred by company engaged in the manufacture or production of drugs, pharmaceuticals, electronic equipments, computers, telecommunication equipments, chemicals or any other article or thing notified by the Board, on scientific research and development facility as is approved by the prescribed authority,</b>	175% is allowed   Full Not allowed  150% is allowed
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**F. Expenditure on acquisition or purchase of patents or copy rights sec 35A**

- a. If expenditure is incurred up to 1/4/98 - 1/14<sup>th</sup> total expenditure is allowed as deduction.
- b. If expenditure is incurred after 1/4/98 – 25% is allowed as depreciation..

**G. Expenditure on Know how sec 35 (AB)**

1. If expenditure is incurred up to 1/4/98.
  - a. Know how (generally) - 1/6<sup>th</sup> is allowed as deduction
  - b. If know how developed in Indian laboratory, university or institution- 1/3<sup>rd</sup> is allowed as deduction
2. If expenditure is incurred after 1/4/98 (From 1<sup>st</sup> April 1998)
  - a. Know how (generally) - – 25% is allowed as depreciation.
  - b. If know how developed in Indian laboratory, university or institution – 25% is allowed as depreciation.

**H. Amortization of telecom license fees Sec 35(ABB).(Capital expenditure)**

1

Amount allowed as deduction = Actual payment made x  $\frac{1}{\text{No of previous years for which the fees is paid}}$

**I. Expenditure on eligible projects or schemes (Sec 35AC)- Full amount allowed as deduction**

**J. Payment to associations and institutions for carrying out rural development programmes (Sec 35CCA) – Full amount allowed as deduction.**

**K. Payment for carrying out programmes of conservation of natural resources (Afforestation) (Sec 35CCB)- Full amount allowed as deduction**

**L. Amortization of certain preliminary Expenses: (Sec.35D):**

U/s 350, the deduction is allowed only in case of an Indian Company or a person resident in India. The deduction is in respect of the expenditure incurred after 31<sup>st</sup> March 1970 and Expenditure may be of the type which was incurred

- a. before the commencement of the business, or
  - b. After the commencement of the business, or in connection with the extension of its industrial undertaking or in connection with its setting up a new industrial unit.
- Deduction = 1/5<sup>th</sup> of expenditure is allowed as deduction.

**M. Expenditure on demerger or amalgamation Sec 35DD – 1/5<sup>th</sup> is allowed as deduction**

**N. Amortization of expenses on prospecting etc for development of certain minerals (Sec 35E)- 1/10<sup>th</sup> is allowed as deduction**

**O. Other Deductions (SEC.36)**

Following expenses are fully allowed as deductions

1. Employees insurance
2. Bonus
3. Commission
4. Employer contribution to RPF.
5. ESI(Employees state insurance)
6. Gratuity fund (Approved)
7. Super annuation fund (Approved)

8. Interest on borrowed capital.
9. Loss of animals (Otherwise than as stock in trade).
10. Bad debts

**P. Family planning expenditure sec 36(1)(ix)**

1. Revenue expenditure - Fully allowed as deduction
2. Capital expenditure - 1/5<sup>th</sup> is allowed as deduction

**Q. Expenditure incurred by a corporation or body corporate (w.e.f 1/4/02) [Sec 36(1) (Xii)] - Full amount allowed as deduction.**

**General Deductions (Sec 37)**

Sec. 37 (i) says that any expenditure (not being expenditure of the nature described in Sec.30 to 36) and not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head, "Profits and Gains of Business or profession".

**Note**

- a. The expenditure should not be of the type of expenses already covered under Sec.30 to 36 of this Act.
- b. Expenses should have been incurred in the relevant accounting year.
- c. Expenses should be in respect of the business carried on by the assessee and the profits of which are to be computed and assessed, and should be incurred after the business is set up.
- d. Expenses should not be in the nature of personal expenses of the assessee.
- e. The expenses should have been incurred totally and exclusively for the purposes of the business of the assessee.
- f. Expenses are not of capital nature.
- g. The expenses are incidental to the business of the assessee and directly spring from the carrying on of it.
- h. The reasonable expenditure towards payment of compensation to the employees whose services have been terminated would ordinarily come under the provisions of Sec. 37(1)
- i. Deposit made under own your Telephone (OYT).

**Entertainment Expenditure**

With effect from AY 1998 – 99 (Sec. 37 (2) has been deleted and as such all expenses incurred on entertainment shall be fully allowed but these shall be subject to provisions of section 37(1).

**Advertisement Expenditure**

All restrictions imposed u/s 37 (2A) have been removed by deleting sec. 37 (2A) with effect from AY 1998 – 99. As such all expenses on advertisement shall be fully allowed.

Any expenditure incurred on advertisement in souvenir or magazine of a political party is not allowed to be debited.

But with effect from 1.4.1998 the cost of signboard, being capital expenditure, shall qualify for depreciation @ 10% and cost of neon sign board @ 15% (being electric installation)

**Q: Explain the allowable deductions u/s sec. 37.**

- All expenses and payments made for purchasing of raw materials, manufacture and sale of goods
- All expenses in the nature of advertisement to pushup sales and not covered u/s 37 (3)
- Sales – tax and expenses to carry on business.
- Day – to – day expense's carry on business.
- Some subscription to be compulsorily and to protect the business interests.
- Reasonable expenses incurred and Diwali / pooja or other Festivals etc.
- Reasonable expenses incurred at the time mahurt and Diwali. But no monetary ceiling has been fixed by Board.
- Royalty paid in connection with the use of trademarks, patents, copy rights, etc.
- Commission paid to procure orders.

- Compensation paid to an agent in connection with the termination or modification in the terms and conditions of his agency.
- Installation expense's of new telephone and payment made under ' own your Telephone (O.Y.T) scheme.
- Expenses incurred to oppose the threatened nationalization of the business.
- Legal expenses incurred to claim damages or compensation in case of non – fulfillment of a contract.
- Pension, gratuity and other voluntary payment given to the employees.
- Gifts given t the employees but such gifts should not fall in the category of perquisites.
- Bonus paid on the basis of an industrial award.
- Expenses incurred on employees welfare activities.
- Embezzlement by an employee during the normal course of the business.
- Amt spent or payable on delayed payment of cash.

**Q: Explain the expenses “specific allowances” expressly disallowed u/s 40.**

**Any assessee**

**A. In the case of any Assessee u/s 40(a)**

**i. Reduction of tax at source: u/s 40 (a) (i):** With effect from 1.4.2004 deduction of interest, royalty, fees for technical services or other sums chargeable under this Act shall be allowed to be debited only if tax is deducted at source and is paid before the expiry of time prescribed u/s 200 (1).

**ii. Any other tax:** Any firm paid on account of any rate of tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the business of any such profits or gains is not allowed.

**iii. Weather tax levied on Business Assets:** Wealth tax which is levied on the assets of the business according to the wealth – tax Act, 1957, will be allowed.

**iv. Salary payable out side India:** It is related with under the head salary.

**Any Firm**

**B. In the case of any firm [Sec. 40(b)]**

a. Any payment of salary, bonus, commission or remuneration by what so ever name called, to any partner who is not a working partner shall be disallowed.

b. Any payment or remuneration to working partner shall also be disallowed if is not authorized of deed.

c. Any payment of interest any partner which is authorized by and is in a accordance with the terms of partnership deed does not exceed 12% p.a.

**General (Disallowed)**

**C. General**

- Drawings private or personal expenses of the proprietors partners etc.
- Any expenditure in the nature of capital expenditure.
- The amount paid as charity and presents. However, subscription is allowed.
- Any provision or reserve except the special reserve of the approved financial corporations.
- Past losses charged to P & L a/c
- Any other expenditure which was incurred not necessarily, wholly and exclusively for the purpose of the business or profession of the assessee.
- Income tax, wealth tax and any other tax which is imposed on income.
- Any provision for bad debts, taxation etc.
- Depreciation in excess of the admissible amount under the provisions of the IT Act,
- Payments to relatives u/s 40A (2)
- Payments exceeding Rs. 20,000 u/s Sec. 40A (3).

**Q: Explain the deemed profits.**

**i. Deemed profits (u/s 41)**

The finance Act 1992 has substituted the sub – section 41(i) by the following with effect from assessment year 1993 – 94. Where an allowance or deduction has been made in the assessment for any year



in respect of loss, expenditure or trading liability incurred by the assessee (here – in – after referred to as first mentioned persons ) and subsequently during any previous year

1. The first mentioned person has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation.
2. In case such benefit or cash is obtained by successor in business in manner whatsoever in respect of which loss or expenditure was incurred by first – mentioned person the provisions mentioned in (a) above shall be applicable against such successor in business and he shall be liable to pay tax on such deemed profit.

**ii. Balancing charge [Sec. 41(2)]:** In case any building plant and machinery or destroyed or discarded during the year and on which depreciation has been claimed by the assessee on straight line method the excess of amount realized over W.D.V. shall be deemed as business profit but it shall not exceed depreciation allowed on such asset.

**iii. Profit on sale of assets used for scientific research [Sec. 41(3)]:** Where capital asset was purchased for scientific research and is sold without having been used for any other purpose, excess amount of sale price added with the deduction allowed over the capital cost of the asset is taxable as deemed income of the year in which sale was affected.

**iv. Bad debts allowed earlier but recovered [Sec. 41(3)]:** Bad debts allowed earlier but recovered later shall be deemed profits of the year in which they are recovered.

**v. Amount withdrawn from special reserve [Sec. 41(4A)]:** In case a deduction has been allowed u/s 36 (1) (viii) in respect of any amount transferred to special reserve and subsequently some amount is withdrawn from such special reserve, the amount so withdrawn shall be deemed as income under the head “Profits & Gains” of the year in which amount is withdrawn.

**Q: Explain which losses are treated as business.**

**Losses are treated as business**

- a. Loss by theft and embezzlement by employee.
- b. Loss of cash due to robbery while being carried by cashier for disbursement;
- c. Loss of cash by dacoit in case of a banking company;
- d. Brokerage, commission and stamp duty incurred on rent deed for hiring office premises.
- e. Loss due to accident fire in stock – in – trade.
- f. Loss caused by white ants.
- g. Loss caused due to theft of pledged goods.
- h. Loss on sale of securities held by assessee as a trading asset.
- i. Loss due to fire of hired machinery.
- j. Loss of stock – in – trade due to entry action.
- k. Loss of stock due to natural calamities.
- l. Loss due to fluctuations in the rate of foreign currency.
- m. Loss due to failure or insolvency of assessee bank.
- n. Loss due to forfeiture of security deposit.
- o. Loss due to non – acceptance of delivery of goods.

**Q: Explain the procedure for computation of business income and professional income.**

**Computation of business income Business income**

Particular	Amount	Amount
<b>Net Profit as per P &amp; L a/c</b>		<b>XXX</b>
<b>Add: In admissible or disallowed expenses but included in P&amp;L a/c.</b>		
All provisions	<b>XXX</b>	
All taxes except sales tax	<b>XXX</b>	
Rent paid to self	<b>XXX</b>	

All capital loss	XXX	
All charities & Donations	XXX	
Cultivation expense's	XXX	
Any Depreciation if wrongly debited	XXX	
Any fine or penalty	XXX	
Past losses	XXX	
Legal expense's on acquiring assets	XXX	
Salary self	XXX	
Cost of patent rights	XXX	
Preliminary expense's	XXX	
Employers contribution to URPF	XXX	XXX
<b>Less: disallowed income and expenditure which is allowable under the Act has not been debited to P&amp;L a/c.</b>		
Actual bad debts (not charged in P and L a/c)	XXX	
Depreciation (-do )	XXX	
Difference due to under debiting stock	XXX	XXX
<b>Income from Business</b>		<b>XXX</b>

<b>Deduct out of the amount arrived at II. Above any income which is either exempt or not taxable under this head.</b>		
<b>a. Incomes exempted from tax</b>		
Post office saving bank interest	XXX	
Agricultural receipts	XXX	
Gifts from relatives	XXX	
Income – tax refund	XXX	
Bad debt – recovered – disallowed earlier	XXX	
Life Insurance maturity Amount	XXX	
Any capital receipt	XXX	
Withdrawal form PPF	XXX	
<b>b. Income taxable under other heads</b>		
Part – time salary	XXX	
Interest on securities	XXX	
Rent from HP	XXX	
Capital gains	XXX	
Dividend, Bank interest, winning from lotteries etc.	XXX	
Any other business income related to (Legal or illegal)	XXX	

### Computation of Professional income

<b>Professional receipts</b>		
Fees (For all professionals)	XXX	
Operation fees, visiting fees (Doctor)	XXX	
Institute fees (for accountants)	XXX	
Gift from clients (for all professionals)	XXX	
Legal fees, practicing fees (for lawyer)	XXX	
Examiner Fees (For all professionals)	XXX	
All other professional receipts	XXX	XXX
<b>Less : Professional payments</b>		
Office and Administrative expense's	XXX	
Clinic & expense's and dispensary expense's	XXX	
Cost of books	XXX	
Subscription of journals	XXX	

Depreciation	<b>XXX</b>	
Any membership fees	<b>XXX</b>	
Cost of medicine	<b>XXX</b>	
(Op. stock + Purchases – closing stock)	<b>XXX</b>	
All other professional payments	<b>XXX</b>	<b>XXX</b>
<b>Income from profession</b>		<b>XXX</b>

ANNAI WOMEN'S COLLEGE