

ANNAI WOMEN'S COLLEGE,

KARUR

INCOME TAX THEORY,

LAW & PRACTICE

(16CCCCM14)

By

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INCOME TAX THEORY, LAW & PRACTICE

Objective: To enable the students to know the provisions of income tax.

Unit- I

Basic concepts – Definition - previous year –assessment year – person, assessee, income, total income, casual income, capital and revenue - residential status and incidence of tax, incomes exempt under section 10.

Unit- II

Salary – Basis of charge – different forms of salary, allowances, perquisites and their valuation – deduction from salary –Computation of taxable salary.

Unit- III

House property – basis of charge – determination of annual value - GAV, NAV – income from let-out property – self occupied property – deductions-Computation of taxable income.

Unit- IV

Profits and gains of business and profession – basis of charge – methods of accounting – deductions – dis allowances, Computation of taxable income.

Unit - V

Capital gains – basis of charge – short and long term capital gains – indexed cost of acquisition and improvement – exemptions – chargeability of short and long term capital gains – computation of taxable capital gains. Income from other sources – interest on securities, etc. deduction under Sec 80C – Introduction to direct taxes code.

Theory: 25% Problem: 75%

I - UNIT
BASIC CONCEPTS, MEANING AND DEFINITION

Meaning of tax

The tax is a compulsory payment that has to be made by individual or other persons to central government, state government or local government. Tax is based on certain will establishment rules or criteria such as income earned, property owned or expenditure made.

Direct and indirect tax

Direct and indirect tax Direct tax is a payment directly made to the stable by the person who bears it. Indirect tax is a tax which is paid by one person and burned by another person.

Income tax act

The income tax act of 1961 has been in effect from the first day of April 1962 (sec 1). It contains 298 sec, sub sections, schedules etc. the income tax rules of 1962 was framed by central board of Direct Taxes (CBDT).

Assessment year (sec 2(9))

Assessment year may be defined as a year in which the income tax of the previous year is to be assessed. It is a period of twelve months starting from April 1 of every year and ending on March 31 of the next year.

Previous year (sec 3)

For the purposes of this Act, the term “previous year” means that the financial year immediately preceding the assessment year. ... Under Income Tax, the returns are filed by assesses after end of the year/ period during which earnings are made and that period is called as previous year/ financial year.

Definition of 'Assessee'

Section 2(7) of Income Tax Act. As per S. 2(7) of the Income Tax Act, 1961, unless the context otherwise requires, the term “Assessee” means a person who is responsible for payment of any tax or any other sum of money under this Act, and includes.

Person 2(31)

It includes an individual and Hindu Undivided Family (HUF), Company, Firm, Association of Person (AOP), Body of Individual (BOI) Local Authority & Artificial Juridical Persons.

AGRICULTURAL INCOME (SEC 2(1A))

In India, agricultural income refers to income earned or revenue derived from sources that include farming land, buildings on or identified with an agricultural land and commercial produce from a horticultural land. Agricultural income is defined under section 2(1A) of the Income Tax Act, 1961.

Different types of Agricultural Income

- Rent or Revenue Derived from land.
- Income from Agriculture Operations.
- Income from Farm House/Building Attached to Agricultural Land.

Non-agricultural income from land

- Income from markets
- Income from stone quarries
- Income from mining royalties
- Income from land used for storing agricultural produce
- Income from supply of water for irrigation purpose
- Income from self-grown, grass and trees
- Income from fisheries
- Remuneration received as manager of an agricultural farm
- Income from interest on arrears of rent of agricultural land

INCOME EXEMPTED FROM TAX

Meaning and importance of residential status The taxability of an individual in India depends upon his residential status in India for any particular financial year. The term residential status has been coined under the income tax laws of India and must not be confused

with an individual's citizenship of India. An individual may be a citizen of India but may end up being a non-resident for a particular year. Similarly, a foreign citizen may end up being a resident of India for income tax purposes for a particular year.

Also to note that the residential status of different types of persons via an individual, a firm, a company etc is determined differently in this article, we have discussed about how the residential status of an individual taxpayer can be determined for any particular financial year.

How to determine residential status?

For the purpose of income tax in India, the income tax laws in India classify taxable persons as:

- A resident
- A resident not ordinarily resident (RNOR)
- A non-resident (NR)

The taxability differs for each of the above categories of taxpayers. Before we get into taxability, let us first understand how a taxpayer becomes a resident, an RNOR or and NR.

Resident

A taxpayer would be qualified as a resident of India if he satisfies any one of the following 2 conditions:

- Stay in India for a year is 182 days or more
- Stay in India for the immediately 4 preceding years is 365 days or more and 60 days or more in the relevant financial year

In the event an individual leaves India for employment during an FY, he will be qualified as a resident of India only if he stays in India for 182 days or more. else the condition (b) above 60 days will not apply to him.

Resident Not Ordinarily Resident

If an individual qualifies as a resident, the next step is to determine if he/she is a Resident ordinarily resident (ROR) or an RNOR. He will be a ROR if he meets both the following conditions:

- Has been a resident of India For at least 2 out of 10 years immediately, For the previous years
- Has stayed in India for at least 730 days in 7 immediately after the preceding years

Therefore, if any individual fails to satisfy even one of the above conditions, he would be an RNOR.

Non-resident

An individual satisfying neither of the conditions stated in (a) or (b) above would be an NR for the year.

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II – UNIT

Income Under the Head Salary

Salary

Salary comes into existence as a result of employer-employee relationship. In an employer-employee relationship, employee performs his duties and the employer provides him salary.

Allowances

Allowances are part of salary given to employees to meet some particular requirements such as house rent, conveyance, etc. Allowances may be fully taxable, partially taxable or fully exempt.

House Rent Allowance [S. 10(13A) & Rule 2A]

The least of the following is exempt from tax:

- 50% of salary, (residential house situated at Mumbai, Kolkata, Delhi or Chennai) and 40% of salary where residential house is situated at any other place;
- Actual house rent allowance received by the employee;
- Excess of rent paid over 10% of salary

Leave Encashment [S. 10(10AA)]

Encashment of earned leave while in service will be treated as income. S. 17(1)(v)

(a). Encashment of earned leave on retirement would however, be exempt to the extent of least of:

- 10 months' salary calculated on the basis of last 10 months average salary or
- Rs. 3,00,000
- Amount equivalent to earned leave
- Actual amount paid by the employer

Entitlement of earned leave should not exceed 30 days for every year of actual service. Limits provided for aggregate maximum from any number of employers. Encashment of earned leave on retirement would be wholly exempt for employees of Central/State Government.

Perquisite

Perquisite is defined in the Oxford Dictionary as any casual emolument or benefit attached to an office or position in addition to salary or wages. It is a facility provided by employer in kind to the employee for official use or for personal benefit or partly for official purpose and partly for private purpose. Section 17(2) defines perquisite in income tax act. Examples of perquisites are:

1. House accommodation with or without furniture
2. Furniture
3. Servants
4. Gas or electricity or water service
5. Telephone or mobile or fax service
6. Use of computers, laptops, i-Pad, tablets and other electronic devices
7. Sale of assets to employees
8. Loans to employees without interest or at lower interest
9. Club membership
10. Car facility or other vehicles
11. LTC- Leave travel concession
12. Medical facility
13. Education facility
14. Health club or recreational facility
15. Food or snacks provided by employer
16. Contribution to provident fund or pension fund or other welfare fund for the purpose of employee.
17. Monetary obligations of employee paid or reimbursed by the employer
18. Income tax paid on behalf of employee (not TDS)
19. Professional tax paid for employee
20. Reimbursements of any of the above expenses by the employer which is used by the employee or his family members

An employee is referred to as a specified employee [Section 17(2)(iii)] if,

- Employee is Director in the employer company

- Employee has substantial interest in the employer business – 20% or more share in the ownership or profit of the employer company
- Employee has cash taxable salary more than Rs.50,000 during the year.

Perquisites which are taxable in the hands of all categories of employees are:

1. House accommodation with or without furniture
2. Furniture
3. Servant hired by employee
4. Gas or electricity or water service connection in the name of the employee
5. Sale of assets to employees
6. Loans to employees without interest or at lower interest.
7. Club membership for personal use
8. Car facility or other vehicles hired or owned by employee
9. LTC – Leave Travel Concession above limit
10. Medical facility beyond permissible limits
11. Education facility beyond permissible limits
12. Food or snacks provided by employer beyond limits
13. Contribution to provident fund or pension fund or other welfare fund for the benefit of employee above prescribed limits
14. Monetary obligations of employee paid or reimbursed by the employer
15. Income tax paid on behalf of employee (not TDS)
16. Professional tax paid for employee

Perquisites taxable for specified employees only:

1. Furniture provided without house for personal use
2. Servant provided for personal use
3. Gas or electricity or water services provided from one source or from outside agency where connection is in the name of the employer
4. Car facility or other vehicle facility where it is owned or hired by the employer
5. Education facility from own source or outside agency

Perquisites exempted for all employees:

1. Any facility received only for official use
2. Telephone or mobile or fax service at house or for personal use including bills.

3. Use of computers, laptops, iPad, tablet, and other electronic devices for official purpose
4. LTC – Leave Travel Concession within limits
5. Medical facility in hospital maintained by Government or Government approved or maintained by the employer
6. Education facility for employee
7. Health club or recreational facility for employee
8. Food or snacks provided by employer within limits
9. Contribution to provident fund or pension fund or other welfare fund for the benefit of employee within limits
10. Gift or Vouchers up to Rs.5000
11. Training expenses incurred on employee
12. Premium on health and life insurance policy of employee

VALUE OF HOUSING ACCOMMODATION [New Rule 3(1)]

Housing accommodation provided by the employer to the employee may be –

- Furnished or unfurnished
- Rent free or at a concessional rate
- Owned by employer or hired by employer
- Provided by government or not
- Whether provided in a hotel

GRATUITY [Sec 10(10)]

Gratuity is a payment received by an employee by his employer as a gratitude for the employee's services to the organization. It is over & above normal salary & other retirement benefits received by an employee.

Government employees [Sec 10(10) Fully exempt

(i)] Employees covered under Gratuity Act, 1972 [Sec 10(10) Minimum of the following three amounts will be exempt –

- 1) Gratuity received
- 2) Rs.10,00,000 (amount fixed by the government)
- 3) Salary last drawn * Number of completed years * 15/26

(ii)] Other non-government employees, not covered in Gratuity Act [Sec 10(10) (iii)] Minimum of the following three amounts will be exempt –

- 1) Gratuity received

2) Rs.10,00,000 (amount fixed by the government)

3) Average salary * number of completed years * 1/2 For this purpose, salary shall include Basic + DA Basic + DA (forming part of salary) + commission in percentage turnover

- For non-government employees covered by Gratuity act, incomplete year of service is considered as full year only if more than six months is completed. For example: If a person retires after serving for 16 years and 7 months, then completed years of service will be taken as 17 years.
- For non-government employees not covered by Gratuity act, incomplete year of service is not considered even if more than six months is completed. For example: If a person retires after serving for 16 years and 9 months, then completed years of service will be taken as 16 only.
- For non-government employees covered by Gratuity act, average salary means average salary for the ten months immediately preceding the month in which the employee has retired.

PENSION [Sec 17(1) (ii)]

Sometimes employer agrees to pay commute pension. Commutation means payment of one time lump sum amount in place of regular payment. Full or part of pension may be commuted.

- Uncommuted pension is fully taxable in the hands of all employees.
- Commuted pension [Sec 10(10A) (i)] is fully exempt in the hands of government employees.
- Taxability of commuted pension, in case of non-government employees [Sec 10(10A) (ii)], depends upon whether employee has received gratuity at the time of retirement –
 - If employee has received gratuity at the time of retirement, commuted pension is exempted to the limit of 1/3rd of commuted value of full pension.
 - If employee has not received gratuity at the time of retirement, commuted pension is exempted to the limit of ½ of commuted value of full pension.

PROVIDENT FUND

Provident Fund is a fund which is created to help an individual in future i.e. after retirement or death. The employee contributes certain amount every month out of his salary and an equal amount is contributed by the employer. The contributions of both are invested in gilt-edged securities. Interest earned is also credited to the provident fund account of employee.

There are four types of provident fund accounts –

1) Statutory Provident Fund (SPF)

- 2) Recognized Provident Fund (RPF)
- 3) Unrecognized Provident Fund (URPF)
- 4) Public Provident Fund (PPF)

Statutory Provident Fund (SPF)

This fund is mainly for Government/University/Educational Institutes (affiliated to university) employees.

Recognized Provident Fund (RPF)

This scheme is applicable to an organization which employs 20 or more employees. An organization can also voluntarily opt for this scheme. All RPF schemes must be approved by The Commissioner of Income Tax.

Unrecognized Provident Fund (URPF)

Such schemes are those that are started by employer and employees in an establishment, but are not approved by The Commissioner of Income Tax. Since they are not recognized, URPF schemes have a different tax treatment as compared to RPFs.

Public Provident Fund (PPF)

This is a scheme under Public Provident Fund Act, 1968. In this scheme even self-employed persons can make a contribution. This fund is made by the Government of India for the purpose of promoting savings among the general public. It has no relation with any employee or employer or salary. Every person opens an account for himself. The individual gets every year deduction u/s 80C on the amount deposited in this fund account. Interest is credited to the account every year on rates fixed by the government. This amount is repayable along with interest after minimum specified period (15 years). The whole amount received at the time of withdrawal is fully exempt from tax.

III – UNIT
Income Under the Head House Property

House property consists of any building or land appurtenant thereto of which the assessee is the owner. The buildings include residential buildings (whether self occupied or let out for any purpose), office building, factory building, godowns, flats, etc. as long as they are not used for business or profession by owner.

The appurtenant lands may be in the form of approach roads to and from the public streets, motor garage, courtyard or compound forming part of the building. But such land is to be distinguished from a separate open plot of land, which is not charged under this head but under the head ‘Income from Other sources’ or ‘Income from Business and Profession’, as the case may be.

If a tenant sub- lets the house property, the rent received by him from the sub- tenant in respect of such house property shall be charged under the head ‘Income from Other sources’ or ‘Income from Business and Profession’.

The situation of property is immaterial. It may be situated in India or abroad.

Example: Mr. A has a house. It includes vast open area within its boundaries. This house has been let out at a rent of Rs. 1,00,000 p.m., out of which rent of Rs. 25,000 p.m. is attributable to the open land. In this case, entire rental income is taxable under the head house property.

BASIS OF CHARGE

Section 22 of the Act provides as follows:

“The annual value of a property consisting of any buildings or lands appurtenant thereto of which the assessee is owner, other than such portions of such property as he may occupy for the purposes of 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”.

Thus, the annual value of a property is taxable under this head if all the following conditions are satisfied:

1. The property should consist of any building or land appurtenant thereto.
2. The assessee should be the owner of the property.
3. The property should not be used by the owner for the purpose of any business or profession carried on by him, the profits of which are chargeable to income tax.

Unless all the aforesaid conditions are satisfied, the property income cannot be charged to tax under the head ‘Income from House Property’.

DEEMED OWNERSHIP

As per section 27, the following persons are deemed to be the owners of the property, although they are not the legal owners:

1. Transfer to a spouse or a minor child (a child below 18 years of age)

If an individual transfers any house property to his or her spouse/ minor child without adequate consideration, the transferor in that case is deemed to be the owner of the house property so transferred. However, this would not cover cases where property is transferred to a spouse (or minor married daughter) in connection with an agreement to live apart.

2. Holder of an impartible estate

The holder of an impartible estate shall be deemed to be the individual owner of all properties comprised in the estate. The impartible estate, as the word itself suggests, is a property which is not legally divisible.

3. Member of a Co-operative Society, etc.

A member of a co-operative society, company or other association of person to whom a building is allotted or leased under a House Building Scheme, shall be deemed to be the owner of that building which is allotted to him, although the co-operative society/company/ association is the legal owner of that building. For e.g., a flat is allotted by a cooperative society to its members who enjoy the flat. Technically the co-operative society may be the owner. However, in such situations the allottees are deemed to be owners and it is the allottees who will be taxed under this head.

4. Person in possession of a property

The person who acquires a house without registration in part performance of a contract under section 53A of Transfer of Property Act, 1882 is deemed as owner of this house although it is not registered in his name.

5. Person having right in a property for a period not less than 12 years

The lessee of a building is deemed as owner if the building is leased out to him for 12 years or more.

COMPUTATION OF NET ANNUAL VALUE OF HOUSE PROPERTY

The measure of charging income-tax under this head is the annual value of the property, i.e., the inherent capacity of a building to yield income. The expression ‘annual value’ has been defined in Section 23 of the Income-tax Act.

To determine the Annual Value or Net Annual Value, the following points must be understood:

Expected Rent- this is the sum for which the property might be reasonably expected to be let out from year to year. It can be said to be the most likely rent for a house property.

Municipal Value - it is the value determined by the municipal authorities for the purpose of levying municipal taxes on house property.

Fair Rent- it is the amount which a similar property can fetch in the same or similar locality, if it is let out for a year.

Standard Rent- it is the sum fixed under Rent control Act. Where the property is subject to Rent Control Act, the expected rent cannot be higher than the standard rent fixed under this Act.

Actual Rent- it is the rent received/receivable for the let out period.

Municipal Taxes- these include service taxes (fire tax, water tax, etc.) levied by any municipality or local authority. Deduction in respect of municipal taxes in determining the annual value of house property will be allowed only if the following conditions are satisfied:

- The property is let out during the whole or any part of the previous year (The taxes are not deductible in respect of a self-occupied house property).
- These taxes must be borne by the landlord. (There is no such deduction if the municipal taxes are borne by the tenant).
- The municipal taxes must be paid during the year. (Where the municipal taxes have become due but have not been actually paid, these will not be deductible. The municipal taxes may be claimed on payment basis i.e., only in the year they were paid even if the taxes belonged to a different year).

Composite Rent- When the owner of the building gets along with the rent of the building, rent or hire of other assets (like furniture) or charges for different services provided in the building (e.g. charges for security, lift, air-conditioning, electricity, water, etc.), the total amount so received is called ‘composite rent’. The tax treatment of composite rent is as follows:

- When composite rent is inseparable, i.e. the other party will not accept the letting of one without the other, then such income is taxable as ‘Income from profits and gains of business or profession’ or ‘Income from other sources’.

- When composite rent is separable, the rent of building is taxable as ‘Income from house property’ and rent or hire of other assets and charges for different services is taxable under the head ‘Income from Profits and gains of business or profession’ or ‘Income from other sources’.

Net Annual Value shall be computed in the following manner:

Step-1 Determine the Gross Annual Value of the property.

Step-2 Deduct the municipal taxes actually paid by the owner during the previous year from the Gross Annual Value to arrive at Net Annual Value.

For the purpose computation of net annual value, properties can be classified into 3 categories:

- A. Properties let out.
- B. Properties occupied by the owner for residential purposes or properties not self occupied owing to employment at some other place.
- C. Partly let out and partly self occupied.

- Gross annual value shall be higher of

- (a) Expected Rent
- (b) Actual rent received or receivable.

The higher of Municipal value and fair rental value shall be Expected rent. However, expected rent shall not exceed the Standard rent.

- Net annual value shall be computed in the following manner:

- i. Determine the Gross Annual Value
- ii. Deduct municipal tax actually paid by the owner during the previous year from the Gross Annual Value.

- Deduction from Annual Value (Section 24): W.e.f. Assessment Year 2002-03, income chargeable under the head —Income from house property shall be computed after making the following deductions, namely:

- i. Standard deduction,
- ii. Interest on borrowed capital.

IV – UNIT
Profits and Gains of Business and Profession

Business is an activity of purchase and sell of goods with the intention of making profit. Profession is an occupation requiring intellectual skill. E.g. Doctor, Lawyer etc. Vocation is an activity, which requires a special skill, which is used to earn income. e.g. Painter, Singer etc. For income tax purpose there is no difference between business income, profession income and vocation income.

Section 2 (13) : Business

Business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

Explanation: - Thus business is any activity carried out with the intention to earn profit, whether such an activity is continuous or temporary is immaterial. In determining whether a particular transaction is an adventure in the nature of trade or not, total impression and effect of all relevant facts and circumstances of the transaction have to be seen. To bring a transaction within the term “business”, the transaction must be a “trade” or in the nature of “trade”. Hence everything depends upon the facts and circumstances of the case. E.g. A person making investment of surplus funds in shares or debentures cannot be deemed to be carrying on the business of trading in shares although occasionally he may be selling “some” shares or debentures and making gains thereon.

METHODS OF COMPUTING TAXABLE INCOME

1. Gross Sales or Gross fees as the case may be are to be taken as the base if Receipt and Payment A/c or cash Book is given. From this Gross income expenses which are specifically allowed by the income tax act are deducted to arrive at taxable income.
2. If profit & loss a/c or income & expenditure a/c is given Net Profit or (Surplus) is taken as the base and then following adjustments are made: -
 - 1) Expenses, which are debited, to profit & loss a/c, but disallowed by the Income Tax Act and either fully or partially are added back.
 - 2) Expenses, which are not debited, to profit & loss a/c but which are allowed by the Income Tax Act are deducted.
 - 3) Income that is credited to profit & loss a/c but not taxable at all or taxable under some different head is to be deducted.
 - 4) Income that is not credited to profit & loss a/c, but which is chargeable to tax as business income is to be added.

BASIS OF CHARGE: SECTION 28

Under Section 28 following are the income chargeable to tax under the head Profits or Gains from Business or profession: -

- 1) Profits and Gains of any business or profession that is carried on by the assessee at any time during the previous year.
- 2) Any compensation or other payment due to or received by an assessee for loss of agency due to termination or modification of terms.
- 3) Income derived by a trade, professional or a similar association for specific services performed for its members.
- 4) Any profit on sale of a license granted under Imports (controls) Order 1955 made under Imports & Exports (control) Act of 1947.
- 5) Any cash assistance (by whatever name called) received or receivable against exports under any scheme of Government of India.
- 6) Any duty of customs or excise repaid or repayable as drawback to any person against exports under the Customs and Central Excise Duty's Drawback Rules 1971.
- 7) Any profit on the transfer of the Duty entitlement pass book scheme under export import policy.
- 8) Any profit on the transfer of the Duty free replenishment certificate under export import policy.
- 9) The value of any benefit or perquisite whether convertible into money or not arising from business or exercise of a profession e.g. A gift received by the lawyer from his client.
- 10) Any interest, salary, bonus, commission or remuneration due to or received by partner of a firm from such firm.
- 11) Sum received or receivable in cash or in kind under an agreement for not carrying out any activity in relation to any business or not sharing any know how, patent, copyright, trade mark, license franchise or any other business or commercial right of similar nature or information or technique likely to assist the manufacture or processing of goods or provision of services.
- 12) Any sum received including bonus under Keyman Insurance Policy.
- 13) Any sum received (or receivable) in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.
- 14) Income from a speculative business.

DEDUCTIONS FOR EXPENSES SPECIFICALLY ALLOWED SECTION 30 TO SECTION 43D

1. Rent, rates, taxes, repairs and insurance of building (Section 30):

1) If assessee has occupied the premises as a tenant, rent of the premises and if he has agreed to bear cost of repairs, such cost is allowed as deduction, provided it is not of capital nature.

2) If assessee has occupied premises as the owner; repairs, land revenue, local taxes, insurance premium etc. are allowed as deduction. However, no expenditure in form of capital expenditure is allowed.

2. Repairs & Insurance of machinery, Plant & Furniture (Sec.31):

Amount paid on account of repairs and insurance premium against risk of damage in respect of machinery, plant & furniture are allowed as deduction provided they are not of capital nature.

3. Depreciation u/s 32:

Under Section 32 depreciation on assets is allowed as deduction while computing income from business or profession. To claim this deduction following conditions should be satisfied:

- 1) Assessee should be owner of the asset.
- 2) Asset must be used for the business.
- 3) Such use must be in the previous year.

Depreciation is allowed not on individual asset items, but on block of assets under following categories: -

- 1) Buildings
- 2) Plant & Machinery
- 3) Furniture
- 4) Intangible Assets acquired after March 31, 1998 such as know- how, Patents, Trademarks, licenses, franchises or any other business or commercial rights of similar nature.

The term plant includes ships, vehicles, books, scientific apparatus and surgical equipments used for the business but excludes tea bushes or live stock.

If any asset falling in block of assets is acquired during the year and put to use during the previous year for less than 180 days depreciation on such asset shall be restricted to 50% of the normal depreciation.

No depreciation is allowed on motor car which is manufactured outside India and acquired on or after 1st March 1975 but before 1st April 2001. However, this restriction does not apply if:

- 1) Assessee carries on a business of running the car on the hire for tourist, or
- 2) If assessee is using the car outside India for his business in another country.

If business is carried on in a building not owned by the assessee but acquired on lease or any other occupancy right and any capital expenditure is incurred by him in respect of this building, such expenditure will be considered as cost of asset as if he is the owner of such property.

A. METHOD OF CALCULATING DEPRECIATION

1. Consider total W.D.V. of assets falling in a particular block of assets at the beginning of the year.
 2. Add cost of assets purchased during the previous year.
 3. Deduct Sale Price (or Scrap value) of asset sold, discarded, demolished or destroyed during the year.
 4. On the balance amount i.e. 1+2-3, calculate depreciation at the given rate. If WDV becomes negative, no depreciation is allowed. If all assets in the block are sold depreciation is not allowed even if block has any balance WDV.
- B. In the first year if asset acquired is used for less than 180 days depreciation is restricted to 50% of normal depreciation.
- C. W.e.f. A.Y. 1998-99 an undertaking engaged in generation / distribution of power has an option to claim depreciation on Straight Line Method. Once option is exercised it will apply to all subsequent years.

Additional depreciation

It can be claimed on new plant & machinery acquired after 31st March 2005 by an assessee in the previous year in which it begins manufacturing or producing.

Rate of additional depreciation: 20% of actual cost

Meaning of Profession: The term 'Profession' has been defined in Section 2(36) of the Act to include any vocation. In the case of a profession, the definition given in the Act is very much inadequate since it does not clearly specify what activities constitute profession and what activities do not. 'Profession' involves the concept of an occupation requiring either intellectual skill or manual skill controlled and directed by the intellectual skill of the operator. For example an auditor carrying on his practice, the lawyer or a doctor, a painter, an actor, an architect or sculptor, would be persons carrying on a profession and not a business. The common feature in the case of both profession as well as business is that the object of carrying them out is to derive income or to make profit. The process of making the profit would be the main area of difference between the two while the ultimate object is common to both

Chargeability of income under this head

Section 28 explains that following incomes shall be chargeable to tax under the head —Profit & Gains from Business or Profession:

- 1) Profit and gains of any business or profession carried on by the assessee during the previous year.
- 2) Income of any trade or professional association from specific services performed to its members.
- 3) Profit on sale of import entitlements license or EXIM scrip.
- 4) Cash assistance [CCS]
- 5) Duty drawback
- 6) The value of any benefit or perquisite arising from any business or profession.
- 7) Any interest, salary, bonus, commission or remuneration received/due to a partner from partnership firm.
- 8) Any sum received under an agreement for:
 - (a) not carrying out any activity in relation to any business or
 - (b) not sharing any Know-how, patent, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services. Where above receipts are chargeable to tax under the head —Capital Gain would not be taxable as profits and gains of business or profession. In other words if one income is taxable under one head cannot be taxed twice.
- 9) Any sum received under Key man insurance policy.
- 10) Profits and gains derived from any Speculation business are also chargeable to tax under the head. The speculation business shall be deemed to be transaction in which the following conditions are satisfied:-
 - (a) The Transaction should be a contract for the purchase or sale of stocks, shares or commodities.
 - (b) This contract is periodically or ultimately settled.
 - (c) The settlement would not be by actual delivery or transaction or commodities or script, generally, it is settled through exchanging the difference in prices on the date of delivery.
- 11) any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD;
- 12) Prizes received by the professional players
- 13) Amount received as compensation
- 14) profits from sale and purchase of investment

15) profit from business of speculation

Process of calculating taxable profit in case of business

The profit and loss account or income and expenditure account as prepared by an assessee is adjusted as per previous of the Income-tax Act, Profits or losses as shown by any of these accounts are adjusted according to Section 29 of the Act for preparing a statement of profit or loss or income-expenditure adjustment:

Calculation

Balance as per profit and loss or Income - expenditure account

xxx

Add:

(i) Expenses expressly disallowed but debited to P& L A/c	xxx	
(ii) Expenses not allowed but debited to P&L A/c	xxx	
(iii) Incomes or receipts taxable under this head but not credited to P& L A/c	xxx	
(iv) Capital expenses debited to P & L A/c	xxx	
(v) Personal expenses debited to P & L A/c	xxx	
(vi) Expenses in excess of the allowed amount, debited to P & L A/c	xxx	
(vii) Losses not allowed but debited to P & L A/c	xxx	
(viii) Expenses not relating to the previous year but debited to P & L A/c	xxx	
(ix) Under-valuation of closing stock or over-valuation of opening stock	xxx	xxx

Total Income

xxxx

Less: (i) Expenses expressly allowed but not debited to P & L A/c	xxx	
(ii) Expenses relating to the previous year but not debited to P & L A/c	xxx	
(iii) Losses allowed but not debited to P & L A/c	xxx	
(iv) Incomes or receipts not taxable under this head but credited to P & L A/c	xxx	
(v) Capital receipts credited to P & L A/c	xxx	
(vi) Incomes or receipts taxable under other head but credited to P & L A/c	xxx	
(vii) Over-valuation of closing stock or under-valuation of opening stock	xxx	
(viii) Profits taxable under the head incomes from business or profession.	xxx	xxx

Net Income

xxxx

Computation of taxable income if Receipt and Payment Account or Cash Book is given

Generally this system is followed by professionals under this system, only taxable receipts and payments are taken. Let us discuss the performa for computation of income for professionals.

Gross Professional Earnings

(a) In case of a Doctor

(i) Sale of Medicine	xxx		
(ii) Consultation fee/Visiting fee	xxx		
(iii) Examining fee	xxx		
(iv) Operation fee	xxx		
(v) Nursing home charges	xxx		
(vi) Gift from Patients		xxx	xxx

(b) In case of an Advocate or a Chartered Accountant

(i) Fee from clients	xxx		
(ii) Consultation fee	xxx		
(iii) Audit fee	xxx		
(iv) Income from accounting work	xxx		
(v) Gift from clients	xxx		
(vi) Fee from training institute	xxx	xxx	

Less: Admissible Expenses

(i) Rent of Dispensary	xxx		
(ii) Salaries to compounder's	xxx		
(iii) Cost of Medicines	xxx		
(iv) General expenses	xxx		
(v) Telephone expenses	xxx		
(vi) Motor car expenses (if used for profession)	xxx		
(vii) Depreciation on Motor car/Surgical equipments	xxx		
(viii) Laboratory expenses	xxx		
(ix) Interest on Loan	xxx		
(x) Expenses on professional Magazines/ Journals	xxx	xxx	

Net Income from profession: Gross professional earnings- Admissible expenses

(A) Expenses expressly allowed

(i) Rent, Rates, Taxes, Repairs and insurance for building

According to section 30 of the Act, In respect of rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession, the following deductions shall be allowed

(a) Where the premises are occupied by the assessee—

(i) as a tenant, the rent paid for such premises ; and further if he has undertaken to bear the cost of revenue repairs to the premises, the amount paid on account of such repairs ;

(ii) otherwise than as a tenant, the amount paid by him on account of current repairs to the premises;

(b) any sums paid on account of land revenue, local rates or municipal taxes;

(c) the amount of any premium paid in respect of insurance against risk of damage or destruction of the premises.

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

(i) the amount paid on account of current repairs thereto;

(ii) the amount of any premium paid in respect of insurance against risk of damage or destruction thereof.

(ii) Depreciation

In computing income from business, one of the most important items of allowances is the allowance for depreciation provided by Section 32 of the Income-tax Act. The deduction towards depreciation is very essential to arrive at the income of the assessee and also to amortise the capital cost of the amount invested in buildings, machinery, plant and furniture. The purpose of allowing depreciation is to provide in course of time for the replacement of asset with the help of the capital cost of the asset which is allowed to be amortised over a period of time. Section 32(1)(ii) provides that depreciation shall be charged under Written Down Value method .

(iii) Expenditure on Scientific Research

The term —scientific research means any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries. With a view to accelerating scientific research, Section 35 of the Act provides tax incentives.

(a) If assessee himself busy in-house research activities:

(i) All revenue expenses of previous year related to trade are allowed.

(ii) Revenue expenses incurred in three years prior to previous year: Out of these expenses salary to employees busy in scientific research and cost of material used in scientific research are allowed in the year in which trade was started.

(iii) Capital expenses incurred in previous year stated to trade on scientific research are allowed.

(iv) Capital expenses on scientific research relating to assessee own trade incurred in three years just prior to the previous year are allowed in that year in which trade was started.

(v) Capital expenses in connection with land will not be allowed.

(vi) Unabsorbed capital expenses on scientific research due to lack of profit will be carried forward for indefinite period and can be set-off in any year out of any head of income.

(vii) Depreciation on capital expenses: if any deduction on capital expenses for scientific research has been availed, then no depreciation on such asset will be allowed and if asset used in scientific research is sold out then such value will be taxable.

(b) Some paid to approved Scientific, Social and Statistical Institutions:

If assessee himself is not indulged in Scientific Research (S/R) but pays or donates any amount to such institutions related to his trade on S/R activities then he shall be eligible for deduction equal to 175% of donated amount.

(c) Payment to National Laboratory:

if assessee makes payment to national laboratory, university, IIT, for scientific research purpose, then a deduction of 200% of amount paid shall be given.

(d) Expenses on approved in- house research and Development Facilities:

This section applies on company assessee engaged in producing medicine, electricity equipment, computer, chemical, telecommunication equipment approved by CBDT then a deduction of 200% of amount spent shall be eligible for deduction.

(iv) Expenditure incurred on Patent and Copyright:

if acquisition of Patent or copyright are incurred on or after 1.4.1998 will not be qualified for deduction but before 1.4.1998 1/14 th of total expenses is allowed every year. If assessee has acquired patent rights first and payment is made afterwards then so much of period shall be deducted out of 14 years which are prior to get such rights. The deduction in the left period shall be allowed equally.

(v) Expenditure incurred on Technical Know-how:

Any industrial information and technique which is helpful in production, processing, mines, oil wells and mining stores is known as technical know-how.

If such expenses have been incurred on or after 1.4.1998 then no deduction shall be allowed but before 1.4.1998 deduction equal to 1/6th will be allowed and the first instalment shall be

allowed in the year in which the amount has been paid. If such thing has been developed in any university or in any such laboratory which is in the ownership of Government or company of a public sector, then such deduction shall be allowed in three equal instalments rather than 6 equal instalments

(vi) Deduction for Preliminary Expenditure

Expenses incurred prior to commencement of trade is called preliminary expenses. These expenses are allowed in case of an Indian company or resident individuals business. Such expenses are allowed in to 5 equal annual instalments. Total deduction of such expenses can not be more than 5% of the project or 5% of the total capital of the business.

Dr. A. V. Vatsala

V – UNIT

INCOME FROM CAPITAL GAINS (SEC-45)

Introduction

U/S 45(1) any profits & gains arising from the transfer of a capital asset effected in the previous year shall chargeable to income tax under the head "Capital gains".

- Income arising from the transfer of capital asset.
- Effected in the previous year.

Capital assets [sec 2(14)]

Capital assets refers to property of any kind whether fixed or circulating movable or immovable tangible or intangible held by an assessee including property of his business or profession. Held by connected with his business or profession.

Examples types of capital assets.

- Movable (or) immovable
- Tangible (or) intangible
- Fixed (or) floating
- Goodwill
- Leasehold rights

Types of capital assets

- Short-term capital assets
- Long term capital assets

Short term capital assets [sec 2(42-4)]

- Short-term capital asset refers to any asset, which is held by the assessee for not more than 36 months immediately prior to the date of transfer.
- In case of shares {equity or preference}, securities listed in any recognize stock exchange in India, units of UTI, units of Mutual Fund and Zero coupon bond-if the assessee holds the asset for not more than 12 months immediately prior to the date of transfer.

Long-term capital assets

Any asset, which is held for more than 36 months or 12 months as the case may be, will be termed as long-term capital assets. In other words, all assets other than short-term capital assets are called long-term capital assets.

Short-term capital gain

Any gain from the sale or transfer of short-term capital assets will be termed as shortterm capital gain.

Long-term capital gain

Any gain from the sale or transfer of long-term capital assets will be termed as longterm capital gain.

Indexed cost (section 48)

Indexed cost refers to cost, which has been proportionately converted with the cost inflation index. It includes both cost of acquisition as well as cost of improvement. In case of bonds and debentures, except capital indexed bonds issued by the government no other bonds or debentures should be indexed.

The indexed cost should be calculated as follows:

$$\text{Index Cost} = \frac{\text{Cost}}{\text{Index of the Year of Acquisition (OR) Improvement}} \times \text{Index of the Year of sale}$$

INCOME FROM OTHER SOURCES

Introduction

Any income which is taxable under the act does not place. Under any of the first four heads of income is taxable under the head. It includes (salary, house property, business or profession & capital gain)

- Dividend
- Income from Winnings from lottery, Cross word puzzles, Races, Card games, Gambling and betting.
- Employer contribution to provident fund, received by the employer
- Interest on securities.
- Income from letting on furniture plant and building & Machinery.
- Amount of gifts besides these some other incomes are taxable under this head of income, like interest other than interest on securities, income from royalty, director fees, commission etc.
- Income from sub-letting house

Bond Washing Transaction

It is not advisable to avoid tax. When on the eve of the due date securities are sold a friends or relatives having taxable income below the minimum limit of taxation and bought back immediately after due date, show that he does not remain the owner of the security.

On the due date and is saved from paying tax on their interest it is called a Bond Washing Transaction.

The following formula maybe used to find out the gross amount in different circumstances.
(For the A.Y 2019-20) In the case of an individual

Where the person is resident in India

- a) Interest received on Tax-free government securities-Exempt
- b) Interest received on less-tax central or state government securities not to be grossed up

- c) Interest received on savings (taxable) bonds, if interest exceeds Rs.10,000 Interest received *100/90
- d) Interest recovered on debentures of a local authority or a corporation or debentures of a company listed in a recognized stock exchange in India. Interest received*100/90
- e) Interest received on other debentures and other securities. Interest received*100/90
- f) On income from winnings from lottery and cross word puzzles. Winnings received*100/70

In case of Company

- a) On interest on securities: Interest received*100/90
- b) On interest other than interest on securities: Interest received*100/90
- c) On income from winnings from lottery and cross word puzzles: Winnings received*100/70

Simple format for calculation of Income from Other Sources

Date	Particulars	Amount
	i. Dividend from Indian company	xxx
	ii. Interest from securities	xxx
	iii. Casual income	xxx
	iv. Income from letting of plant and machinery, furniture building etc.	xxx
	v. Family pension	xxx
	vi. Royalty	xxx
	vii. Examinership remuneration	xxx
	viii. Any other income which cannot be included in salary, house property, business or profession, capital gains	xxx
	Income from other sources	xxx

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