INCOME TAX A TO Z

FOR AY 2010-2011 (FY 2009-2010)

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Income Tax Liability

1 The legal position discussed is as applicable for financial year 2009-10 (Assessment Year 2010-11) unless specified otherwise. Provisions as applicable for financial year 2008-09 (Assessment Year 2009-10) are also given, where these are different from provisions applicable to AY 2009-10.

Income tax is levied under Entry No. 82 of List I of Seventh Schedule to Constitution (Union List), which reads, 'Tax on income other than agricultural income'. Entry No. 46 of List II of Seventh Schedule to Constitution (State List) reads, ' Taxes on agricultural income '.

Income Tax Act, 1961 imposes tax on income other than agricultural income. Tax on agricultural income can be imposed only by State Governments.

Section 4 of Income Tax Act, which is the charging section, states that where any Central Act enacts that income tax shall be charged for any assessment year at any rate or rates, income tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income tax) of this Act (i.e. Income Tax Act) in respect of the total income of the previous year of every person.

Income tax Rates fixed under Finance Act every year - The 'Central Act' as referred to in section 4 of Income Tax Act is the 'Finance Act' enacted every year. Income Tax is payable by every assessee at the rates prescribed by Finance Act every year. The Finance Bill is presented at the time of presenting Budget, usually on last day of February every year. The relation between Finance Act and Budget is so close that often people associate budget only with taxation. Really, taxation is only one of the aspects of the Budget.

1-1 ***Who is assessee ?*** - Assessee means a person by whom any tax or any other sum of money is payable under Income tax Act. It includes deemed assessee [section 2(7) of Income Tax Act]

Person - 'Person' includes * Individual * HUF * Company * Partnership Firm * Association of Persons (AOP) or body of individuals whether incorporated or not * Local Authority like Municipality etc. * Artificial Judicial person not falling in any of the aforesaid categories e.g. a Hindu deity [section 2(31) of Income Tax Act]

1-2 ***Previous Year and Assessment Year***

One very confusing aspect of Income Tax for a common man is the difference between Previous Year and Assessment Year.

Assessment year means the period of twelve months commencing on the 1st day of April every year [section 2(9) of Income Tax Act]

Previous year means the financial year immediately preceding the assessment year. If a business/profession is newly set up, previous year is the period from date of setting up that business or profession and ending with the financial year [section 3 of Income Tax Act]

The Financial Year for income tax purposes (called 'Previous Year') is always the year ending 31st March. The 'assessment year' is next to the 'Financial Year' or 'Previous Year' e.g. for Financial Year (FY) 2007-08 (1st April 07 to 31st March 2008), the 'Assessment Year' (AY) is 2008-09.

It may be noted that an assessee can have separate accounting year for his own purposes e.g. a Company can close its accounts on any day of the year, an individual may start his year on Diwali or any other auspicious day. However, for income tax purposes, the accounts must be closed only on 31st March.

1-3 *Residential status*

Income tax liability depends on residential status of a person.

Income Tax liability of a person depends on the residential status. Assessees are either resident in India, or non-resident in India.

A firm, an association of persons, a company and every other person can be either a resident *or* a non-resident.

In case of individuals and HUF, if they are residents, they can be either resident and ordinarily resident, or resident but not ordinarily resident.

Section 6 gives the test of residence for various types of assessees e.g. an individual, a Hindu undivided family, a firm or an association of persons or a body of individuals, a company ; and every other person.

An assessee can have different residential status for different assessment years. It is possible that a person who is resident in India for income tax purposes, may be resident in any other country for the same assessment year.

Residential status of an individual - An individual is resident in India in any previous year, if he satisfies at least one of the following conditions - (a) He is in India in the previous year for a period of 182 days or more ***or*** (b) He is in India for a period of 60 days or more during the previous year and 365 days or more during 4 years immediately preceding the previous year [section 6(1) of Income Tax Act]

However, in case of an Indian citizen who leaves India during the previous year for the purpose of employment outside India or an Indian citizen who leaves India during the previous year as a member of the crew of an Indian ship, or Indian citizen or person of Indian origin, the period of 60 days stands extended to 182 days.

In short, if a person was in India for at least 182 days in the previous year, he will be 'resident' for that year. Otherwise, he will be 'non resident'.

A resident individual will be "resident and ordinarily resident" in India if (a) He has been resident in India in at least 2 out of 10 previous years immediately preceding the relevant previous year ***and*** (b) He has been in India for a period of 730 days or more during 7 years immediately preceding the relevant previous year [section 6(6) of Income Tax Act].

A resident who does not satisfy any one of the aforesaid conditions, will be 'resident but not ordinarily resident'.

Residential status of a HUF - In case of HUF, if control and management of its affairs is wholly or partly situated in India, it will be 'resident in India'. If control and management of its affairs is wholly out of India, it will be 'non-resident in India' [Sec. 6(2 of Income Tax Act]

A resident Hindu undivided family (HUF) can be either ordinarily resident or not ordinarily resident.

A resident Hindu undivided family will be 'ordinarily resident in India' if the *karta* or manager of the family (including successive *karta*) (a) has been resident in India in at least 2 out of 10 previous years immediately preceding the relevant previous year ***and*** (b) has been present in India for a period of 730 days or more during 7 years immediately preceding the previous year.

If even one of the conditions is not satisfied, the HUF will be 'resident but not ordinarily resident in India' [section 6(*6*)(*b*) of Income Tax Act].

Residential status of the firm and association of persons - A partnership firm and an association of persons will be resident in India if control and management of their affairs are wholly or partly situated within India during the relevant previous year. If control and management of their affairs are situated wholly outside India, it will be non-resident in India. [Sec. 6(2)]

Residential status of a company - A company incorporated in India is an Indian company. It will always be 'resident in India'. A foreign company (i.e. company incorporated abroad), is resident in India ***only*** if, during the previous year, control and management of its affairs is situated ***wholly*** in India. [Sec. 6(3) of Income Tax Act]

Residential status of "every other person" - Every other person will be resident in India if control and management of his affairs is wholly or partly situated within India during the relevant previous year. If control and management of his affairs is wholly situated outside India, it will be non-resident [Sec. 6(4) of Income Tax Act]

1-4 Tax liability depending on residential status

Income can be broadly classified as 'Indian Income' and 'Foreign Income'.

'Indian income' is always taxable in India in case of all tax payers, whether resident or non-resident.

'Foreign income' is taxable in India if the assessee is (**a**) resident (in the case of a firm, AOP company and every other person) or (**b**) resident and ordinarily resident (in the case of an individual or a Hindu undivided family) in India.

If an individual or a HUF is resident but not ordinarily resident, foreign income is taxable only if it is (*a*) business income and business is controlled from India, or (*b*) professional income from a profession which is set up in India. Otherwise, foreign income is not taxable in the hands of resident but not ordinarily resident taxpayers [section 5(1) of Income Tax Act]

Foreign income is not taxable if the assessee is non-resident in India [section 5(2) of Income Tax Act]

Section 9 of Income Tax Act defines 'income deemed to accrue or arise in India'. It will be 'Indian Income' and taxable in all the cases.

1-5 *Different heads of income*

All income is classified under following heads of income - * Salaries * Income from House property * Profits and gains of business or profession * Capital Gains * Income from other sources (e.g. interest on securities, lotteries, races) [section 14 of Income Tax Act]

Calculation of income tax - Income from each of these sources is first calculated. All this income is added to find out total income of the assessee. Permissible deductions are reduced and then income-tax payable is calculated at the prescribed rates.

Income from one head can be set off against loss from other head, unless specifically prohibited. In *Rajasthan State Warehousing Corporation* v. *CIT* 2000 AIR SCW 629, it was held that if income is derived from various heads, assessee is entitled to claim deduction permissible under respective head whether or not computation under each head results in taxable income. If income to assessee arises under any of the heads of income but from different items e.g. different house properties or different securities etc., and income from one or more items alone is taxable whereas income from the other item is exempt under the Act, the entire permissible expenditure in earning the income from that head is deductible. - . - If assessee carries business in various ventures, entire expenditure incurred on all ventures is deductible if all ventures constitute one business

1-6 Mode of computation of Income

Sr No	*Particulars*	Rs.
1	Income from salaries, allowances and perquisites	
2.	Less : Deduction under section 16, entertainment allowance and professional tax:	
3.	Taxable income under the head "Salaries" (1-2)	.
4.	Income from house property - Adjusted net annual value	
5.	Less : Deductions under section 24	
6	Taxable income under the head Income from house property (5-6)	
7.	Profits and gains of business or profession - Profit/loss as per P&L account after deducting amounts not allowable as deduction, adding amounts which are allowable as deduction and adding income taxable under this head, though not credited/debited to P&L account	
8.	Less : Incomes which are credited to P & L A/c but are exempt under sections 10 to 13A or are taxable under other heads of income	
9.	Taxable income under the head Profits and gains of business or profession (7-8)	
10.	Capital gains	
11.	Less : Amount exempt under sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G and 54GA	
12	Taxable income under the head Capital gains (10-11)	
13	Income from other sources	
14.	Less : Deductions under section 57	
15	Taxable income under the head Income from other sources (13-14)	
16.	Total Income (3+6+9+12+15)	
17	Less : Adjustment on account of set-off and carry forward of losses	
18.	Less : Deductions under sections 80C to 80U	
19	Total income or net income liable to tax (16-17-18)	
20	Income subject to special rate of tax (e.g. capital gains)	
21	Balance income subject to normal rate (20+21 = 19)	
	Computation of tax liability	
A1.	Tax on net income at special rates	
A2	Tax on income at normal rates	

B	Less : Rebate under section 88E in respect of STT (available for AY 2008-09 but not available for AY 2009-10)	
C	Add : Surcharge	
D	Add: Education cess and secondary and higher education cess	
E	Less : Rebate under sections 86, 89, 90, 90A and 91	
F	Net Tax payable (A1+A2-B+C+D-E)	
G	Tax paid on self-assessment	
H	Tax deducted or collected at source	
I	Tax paid in advance	
J	Balance Tax payable (F-G-H-I)	

Rates of Income Tax

2 Major types of assessees and the rates of tax applicable is summarised here.

2-1 ***Individual*** - An individual may get income from salary, house rent, business, profession, interest etc. He does not have to pay income tax on dividend income at all. An individual may carry out business under some different name. However, this is only for convenience of business or trade. The income of a proprietary firm is added to his income for purpose of income tax. If a person gets salary from a partnership firm where he is a partner, the income is treated as 'business income' though termed as 'salary'.

Tax rates for the assessment year 2010-11 (FY 2009-10) are as follows -

For resident woman (who is below 65 years at any time during the previous year), rates for AY 2010-11 are as follows –

Net income	*Income-tax rates*
Up to Rs. 1,90,000	*Nil*
Rs. 1,90,000 – Rs. 3,00,000	10% of (total income *minus* Rs. 1,90,000)
Rs. 3,00,000 – Rs. 5,00,000	Rs. 11,000 + 20% of (total income *minus* Rs. 3,00,000)
Above Rs. 5,00,000	Rs. 51,000 + 30% of (total income *minus* Rs. 5,00,000)

For resident woman (who is below 65 years at any time during the previous year), rates for AY 2009-10 were as follows –

Net income	*Income-tax rates*
Up to Rs. 1,80,000	*Nil*
Rs. 1,80,000 – Rs. 3,00,000	10% of (total income *minus* Rs. 1,80,000)
Rs. 3,00,000 – Rs. 5,00,000	Rs. 12,000 + 20% of (total income

	minus Rs. 3,00,000)
Rs. 5,00,000 – Rs. 10,00,000	Rs. 52,000 + 30% of (total income *minus* Rs. 5,00,000)
Above Rs. 10,00,000	Rs. 2,02,000 + 30% of (total income *minus* Rs. 10,00,000) plus 10% of income tax as surcharge

For resident senior citizen (who is 65 years or more at any time during the previous year), rates for AY 2010-11 are as follows –

Net income range	*Income-tax rates*
Up to Rs. 2,40,000	*Nil*
Rs. 2,40,000 – Rs. 3,00,000	10% of (total income *minus* Rs. 2,40,000)
Rs 3,00,000 – Rs 5,00,000	Rs 6,000 + 20% (total income *minus* Rs. 3,00,000)
Above Rs. 5,00,000	Rs. 46,000 + 30% of (total income *minus* Rs. 5,00,000)

For resident senior citizen (who is 65 years or more at any time during the previous year), rates for AY 2009-10 were as follows –

Net income range	*Income-tax rates*
Up to Rs. 2,25,000	*Nil*
Rs. 2,25,000 – Rs. 3,00,000	10% of (total income *minus* Rs. 2,25,000)
Rs 3,00,000 – Rs 5,00,000	Rs 7,500 + 20% (total income *minus* Rs. 3,00,000)
Rs. 5,00,000 – Rs. 10,00,000	Rs. 47,500 + 30% of (total income *minus* Rs. 5,00,000)
Above Rs. 10,00,000	Rs. 1,97,500 + 30% of (total income *minus* Rs. 10,00,000) plus 10% of income tax as surcharge

For any other individual, every HUF/AOP/BOI/artificial juridical person, rates for AY 2010-11 are as follows –

Net income range	***Income-tax rates***
Up to Rs. 1,60,000	*Nil*
Rs. 1,60,000 – Rs. 3,00,000	10% of (total income *minus* Rs. 1,50,000)

Rs. 3,00,000 – Rs. 5,00,000	Rs. 14,000 + 20% of (total income *minus* Rs. 3,00,000)
Above Rs. 5,00,000	Rs. 54,000 + 30% of (total income *minus* Rs. 5,00,000)

For any other individual, every HUF/AOP/BOI/artificial juridical person, rates for AY 2009-10 were as follows –

Net income range	***Income-tax rates***
Up to Rs. 1,50,000	*Nil*
Rs. 1,50,000 – Rs. 3,00,000	10% of (total income *minus* Rs. 1,50,000)
Rs. 3,00,000 – Rs. 5,00,000	Rs. 15,000 + 20% of (total income *minus* Rs. 3,00,000)
Rs. 5,00,000 – Rs. 10,00,000	Rs. 55,000 + 30% of (total income *minus* Rs. 5,00,000)
Above Rs. 10,00,000	Rs. 2,05,000 + 30% of (total income *minus* Rs. 10,00,000) plus 10% of income tax as surcharge

Notes:

1. Surcharge – There is no surcharge on income tax for AY 2010-11. For AY 2009-10, surcharge was 10 per cent of income-tax if net income of an individual, Hindu undivided family, association of persons, or body of individuals, exceeds Rs. 10,00,000. In the case of an artificial juridical person, surcharge is 10 per cent of income-tax (*i.e.,* income-tax *minus* rebate under section 88E), even if net income is less than Rs. 10,00,000.

Rebate u/s 88E (in respect of STT) is not available for AY 2009-10.

Marginal relief – Since there is no surcharge fo AY 2010-11, there is no question of marginal relief. For AY 2010-11, in the case of the aforesaid person having a net income of exceeding Rs. 10,00,000, the net amount payable as income-tax and surcharge shall not exceed the total amount payable as income-tax on total income of Rs. 10,00,000 by more than the amount of income that exceeds Rs. 10,00,000.

2. ***Education cess and SAH Education Cess*** - Education cess payable is 2 per cent of income-tax and surcharge. Secondary and higher education cess is 1 per cent of income-tax and surcharge. This is in addition to income tax.

2-2 *HUF* - An Hindu Undivided Family (HUF) consists of all persons lineally descended from a common male ancestor. It is assessable in respect of income derived from the joint family corpus. However, income earned by individual members of HUF in their individual and personal capacities is taxed as their personal income. Such income is not treated as income of HUF. Thus, it is possible to have an income from a proprietary firm (in individual capacity) as well as income from a business of HUF. Both are eligible for separate tax exemptions. Business of HUF can, of course, be conducted in a different name. In such case, the HUF will be proprietor of the firm in the name of which business is being conducted.

It may be noted that there is no question of ‘forming’ an HUF, as every male Hindu automatically has ‘HUF’. A Hindu male can have his own separate HUF even if his father or son has separate HUF. One

HUF with only one male member is permissible. Any 'HUF' can have business run by head of the HUF called '*karta*'.

If an individual throws his separate property into the property of HUF, income from such converted property will be included in the total income of such individual. Hence, the HUF business should be from independent source of capital and not from the funds provided by an individual member of the HUF. Thus, if an HUF intends to conduct a business, its financial resources have to be carefully planned.

HUF should start business with loans / gifts from unrelated persons / bankers. Accounts and finances of HUF business should be kept separate. Otherwise, there is a possibility that income of HUF will be clubbed with the income of an individual.

The income of HUF is chargeable at the same rate as individual income as stated above. Thus, if an individual splits his business - partly in his individual capacity and partly in name of firm owned by HUF, considerable tax saving is possible, if done systematically and carefully.

2-3 ***Partnership Firm*** - Income of the partnership firm has to be calculated after deducting salary and interest payable to partners at prescribed rates. Specific provisions in respect of partnership firm have been explained later.

A firm is taxable at the rate of 30 per cent for the assessment year 2008-09 and 2009-10 and 2010-11. There is no surcharge for AY 2010-11. For AY 2008-09 and 2009-10, Surcharge @ 10 per cent of income-tax [*i.e.*, income-tax after rebate under section 88E] was payable, if net income exceeds Rs. 1 crore. Marginal relief was available where net income exceeds Rs. 1 crore. In addition, Education cess is 2 per cent of income-tax (after rebate under section 88E) and surcharge. Secondary and higher education cess is 1 per cent of income-tax (after tax rebate under section 88E) and surcharge.

2-4 ***Company*** - The tax on income is as follows -

In case of domestic company, income tax is @ 30% for assessment year 2008-09, 2009-10 and 2010-11. Surcharge @ 10 per cent of income-tax [*i.e.*, income-tax after rebate under section 88E], if net income exceeds Rs. 1 crore. Rebate u/s 88E is not available for Assessment Year 2009-10.

In case of foreign company, income tax is @ 40% for assessment year 2008-09, 2009-10 and 2010-11. Surcharge @ 2.5% of income-tax [*i.e.*, income-tax after rebate under section 88E], if net income exceeds Rs. 1 crore. Rebate u/s 88E is not available for Assessment Year 2009-10.

Marginal relief is available where net income exceeds Rs. 1 crore. In addition, Education cess is 2 per cent of income-tax (after rebate under section 88E) and surcharge. Secondary and higher education cess is 1 per cent of income-tax (after tax rebate under section 88E) and surcharge.

Dividend Distribution Tax - A domestic company paying dividend will have to pay dividend distribution tax u/s 115-O. The rate applicable w.e.f. 1-4-2007 is 15% plus surcharge @ 1.5% plus education cess @ 2% plus SAH education cess of 1% of income tax. Total 16.995%.

Dividend distribution tax is payable within 14 days from date of declaration/distribution/payment of dividend whichever is earlier. The dividend will be tax free at the hands of assessees.

Mutual funds have to pay dividend distribution tax u/s 115R of Income Tax Act. The rate as applicable w.e.f. 1-4-2007 is 12.5% on income distributed to any individual or HUF and 20% on income distributed to any other person. In addition, surcharge, education cess @ 2% and SAH education cess @ 1% will be payable. Total is 14.1625% in case of individual or HUF unit holder and 22.66% in other cases.

In case of money market mutual fund or a liquid fund, rate is 25%. Including surcharge and education cess, it is 28.325%.

The dividend will be tax free at the hands of assessees.

Income distributed to unit holders of open ended equity oriented funds or US 64 is exempt from dividend distribution tax.

2-5 Minimum Alternate Tax

Many companies charge depreciation in their books on straight line method. Thus, the profit shown is higher in the accounts maintained for company law purposes and they can declare dividend. However, for income tax purposes, they charge depreciation on WDV which is higher. Thus, for income tax purposes, they may show low profit or even loss, while in balance sheet prepared for company law purposes, they will show high profits, which is called 'book profits. Hence, such companies have to pay minimum income tax [section 115JB]. This tax is termed as 'Minimum Alternate Tax' (MAT).

In *Apollo Tyres* v. *CIT* (2002) 122 Taxman 562 (SC 3 member bench), it was held that the assessing officer cannot reopen the accounts certified by auditors and adopted in general meeting. He has limited powers of making additions and reductions as provided in the section. [In this case, it was held that assessing officer cannot add back the depreciation for earlier years provided in accounts].

Rate of minimum alternate tax, as % of book profit is as follows, for Assessment Year 2010-11 -

	If book profit does not exceed Rs. 1 crore			*If book profit exceeds Rs. 1 crore*			
	IT %	*EC and SAHC %*	*Total*	*IT*	*SC*	*EC and SAHC*	*Total*
Domestic company	15	0.3	15.45	15	1.5	0.495	16.995
Foreign company	15	0.3	15.45	15	0.375	0.46125	15.83625

Marginal Relief - If book profit of a company exceeds Rs. 1 crore, the minimum alternate tax cannot exceed the following : (Rs. 15 lakh + Book profit – Rs. 1 crore) + EC + SAHC.

Rate of minimum alternate tax, as % of book profit were as follows, for Assessment Year 2008-09 and 2009-10.

	If book profit does not exceed Rs. 1 crore			*If book profit exceeds Rs. 1 crore*			
	IT %	*EC and SAHC %*	*Total*	*IT*	*SC*	*EC and SAHC*	*Total*
Domestic company	10	0.3	10.30	10	1	0.33	11.33

Foreign company	10	0.3	10.30	10	0.25	0.3075	10.5575

Marginal Relief - If book profit of a company for the assessment year 2008-09 exceeds Rs. 1 crore, the minimum alternate tax cannot exceed the following : (Rs. 10 lakh + Book profit – Rs. 1 crore) + EC + SAHC.

2-6 Co-operative societies - Following rates are applicable to a co-operative society for the assessment year 2008-09, 2009-10 and 2010-11

Net income	**Rate of income-tax**
Up to Rs. 10,000	10
Rs. 10,000 - Rs. 20,000	20
Rs. 20,000 and above	30

No surcharge applies, but education cess @ 2% of tax and SAH education cess @ 1% of tax is payable.

Various exemptions are available to cooperative societies u/s 80P of Income Tax Act. However, there is no exemption to urban cooperative banks.

7 *Local authorities* - Tax rate is 30%. No surcharge applies, but education cess @ 2% of tax and SAH education cess @ 1% of tax is payable.

2-7 Capital gains

In case of short term gains covered under section 111A of Income Tax Act , the rate is 10% for AY 2008-09 and 15% for Assessment Year 2009-10 and 2010-11. Section 111A is applicable in respect of securities transactions which are subject to securities transaction tax.

In case of long term capital gains, tax rate is 20% for AY 2008-09, AY 2009-10 and AY 2010-11 [section 112].

There is no surcharge for AY 2010-11. Surcharge for AY 2009-10 was 10% in case of (a) individual/HUF/BOI/AOP if income exceeds Rs 10 lakhs and (b) in case of company/firm if income exceeds Rs one crore.

In addition, education cess @ 2% of tax and SAH education cess @ 1% of tax is payable.

2-8 *Wealth-tax*

Wealth tax for individual, HUF or a company is 1% in respect of wealth over Rs 30 lakhs for Assessment Year 2010-11. There is no surcharge or education cess.

Wealth tax for individual, HUF or a company was 1% in respect of wealth over Rs 15 lakhs for Assessment Year 2008-09 and 2009-10. There is no surcharge or education cess.

One house or part of house belonging to an individual or HUF is excluded for purpose of wealth tax. The assets have to be valued as per Valuation Rules.

Income from Salary

Income from salary

1. Income under the head 'salary' comprises of remuneration in any form (including perquisites) received by an employee from employer. Thus, there should be contractual employer-employee relationship. The contract may be express, oral or implied.

Salary is chargeable on due or receipt basis. Arrears of salary paid or allowed are includible if not charged to income tax for any earlier previous year [section 15 of Income Tax Act]

'Salary' includes * wages * dearness allowance * Bonus * gratuity * annuity or pension * advance of salary * Fees / Commissions perquisites/ profits received from employer in addition to salary * Leave encashment while in service * Employer's contribution to provident fund in excess of 12% of salary of employee * profit in lieu of salary [section 17(1) of Income Tax Act]

In *Karamchari Union* v. *UOI* 2000 AIR SCW 806 = AIR 2000 SC 1226 = (2000) 109 Taxman 1 = 2000 LLR 897 = 243 ITR 143 (SC), it has been held that CCA (City Compensatory Allowance), DA (Dearness Allowance) and HRA (House Rent Allowance) are in nature of income forming part and parcel of salary and are taxable.

1-1 Allowances

House rent allowance - Exemption will be *lowest of* (a) 50% of salary where residential accommodation is in Mumbai, Kolkata, Delhi or Chennai and 40% of at other place (b) Excess of rent paid over 10% of salary (c) Actual allowance paid. There will be *no exemption* if the residential accommodation is owned by employee or employee has not paid any rent for residential accommodation used by him [section 10(13A) of Income Tax Act and rule 2A]

Salary means basic plus DA (if forming part of retirement benefits) plus commission (if fixed as a percentage of turnover).

Gratuity - Gratuity for Government employees is fully exempt [section 10(10)(i)]. In case of employees covered under Payment of Gratuity Act, exemption is upto Rs 3,50,000 to be reduced by such exemptions claimed in the past or 15 days salary for every completed year of service, whichever is lower.. Salary means basic plus DA (if forming part of retirement benefits) [section 10(10)(ii) of Income Tax Act] Any other gratuity is also exempt to same extent [section 10(10(iii)]of Income Tax Act]

Leave encashment - Encashment of earned leave on retirement of employees of Central/State Govt is fully exempt [section 10(10AA)(i) of Income Tax Act] . Leave encashment while in service is treated as part of salary. In other cases, leave encashment of earned leave on retirement will be lowest of 10 months' salary, Rs three lakhs or actual sum received [section 10(10AA)(ii) of Income Tax Act]

LTA/LTC - Leave Travel Assistance/Leave Travel Concession is allowed twice in a block of four years. It is limited to amount actually spent on travelling of employee and his family members. It is limited to economy class of air fare or AC first class fare [section 10(5) of Income Tax Act and rule 2B]

The allowance is exempt subject to amount of expenses actually incurred by the employee for such travel. The employee will have to keep account of actual expenses incurred. It appears that actual travel by air or AC is not required, but the overall ceiling on expenses is subject to limit of air fare / rail fare.

VRS (Voluntary Retirement) - It is exempt upto Rs five lakhs if VRS is as per prescribed conditions.

Medical treatment - Reimbursement of amount actually spent for medical treatment upto Rs 15,000 is exempt in a financial year. In addition, reimbursement of insurance premium for self, spouse, children and dependent brothers, sisters and parents is exempt.

In case of treatment in Government or approved hospital, or expenditure on medical treatment outside India, reimbursement of medical expenses is exempt without any ceiling.

1-2 *Valuation of perquisites* - The employer often gives some perquisites to the employees. Value of these perquisites is added to the income of employees. The valuation of perquisites is done as follows :

Rent Free unfurnished Accommodation - - In case of private sector employees, value of perquisite of rent free unfurnished accommodation is taken as follows - (a) If owned by employer - If population of city exceeds 25 lakhs - 15%, if population exceeds 10 lakhs but below 25 lakhs - 10% (c) In other cases - 7.5%.

In case of Government Employees, value will be rent as per rules framed by Government, as reduced by sum actually paid

Salary includes basis, DA (if taken into account for retirement benefit), bonus, commission, fees and all taxable allowances.

Valuation of furnished accommodation - If accommodation is furnished, in addition to above, 10% of cost of furniture (including TV, radio, refrigerator, AC etc.), if owned by employer, will be treated as perquisite. If the furniture is hired from third party, actual hire charges less any amount recovered from employee will be the perquisite.

Gas electricity or water supply - Some benefits like gas, electricity, water are valued at actual cost to employer. If these are provided from own sources, value will be manufacturing cost incurred per unit, less amount recovered from employee.

Domestic servants - Actual cost to employer for sweeper, gardener, watchman or personal attendant will be value of perquisite.

Use of movable assets - If some movable asset is provided to employee, perquisite will be @ 10% of the cost of asset or rent paid, as reduced by sum paid by employee.

Loans to employees at concessional rate - Calculate interest on basis of SBI lending rates, reduced interest paid by employee and difference will be the value of perquisite.

1-3 Perquisites which will be added to salary

Remaining perquisites perquisites like motor car, lunch, refreshment, travelling, touring, gift, credit card, club etc. will be added to salary and taxed in hands of individual (Till 31-3-2009, FBT was payable by employer and hence these were exempt at hands of employee).

Valuation of motor car -.If car is owned or hired by employer and provided for personal purposes of employees, valuation will be expenditure incurred by employer on running and maintenance plus remuneration of chauffer plus normal wear and tear @ 10% on actual cost less amount charged to employees.

If motor is partly for official and partly for personal purposes and expenses are reimbursed by employer, perquisite value per month is Rs 1,2000 per month if engine cubic capacity is upto 1.6 liters and Rs 1,600 per month if cubic capacity of engine exceeds 1.6 liters.

If motor is partly for official and partly for personal purposes and expenses are reimbursed by employer, perquisite value per month is Rs 1,200 per month if engine cubic capacity is upto 1.6 liters and Rs 1,600 per month if cubic capacity of engine exceeds 1.6 liters. If chauffer is provided, value of perquisite will be Rs 600 per month.

If motor is partly for official and partly for personal purposes and expenses are met by employee, perquisite value per month is Rs 400 per month if engine cubic capacity is upto 1.6 liters and Rs 600 per month if cubic capacity of engine exceeds 1.6 liters. If chauffer is provided, value of perquisite will be Rs 600 per month.

Other amounts paid - Club fees paid on behalf of employee, insurance premiums paid on behalf of employee, income tax paid on behalf of employee are all treated as perquisites and its cost is added to income of employee.

Gifts - Gifts upto Rs 5,000 per year are exempt.

1-4 *Deductions from Salary Income* - Following deductions are permissible from salary income -

Professional Tax paid to State Government is allowable as deduction

Entertainment allowance upto Rs 5,000 is allowable to Government employees.

1-5 *Exemptions for salary income* - Following are exempt from income tax-

Transport allowance upto Rs 800 per month granted to an employee to meet his expenditure for the purpose of commuting between place of residence and the place of his duty.

Conveyance and transport allowance granted to employee to meet cost of travel on tour are exempt. Allowance granted to meet expenditure incurred on conveyance in performance of duties of an office or employment are exempt. In *LIC Officers* v. *LIC of India* (2000) 112 Taxman 227 (Bom HC DB), it was held that conveyance allowance is exempt only if expended for meeting expenses wholly and necessarily incurred or to be incurred in performance of duties of office. Conveyance allowance at flat rate irrespective of place of residence, work and posting will *not* be exempt from income tax.

Conveyance and transport allowance granted to employee to meet cost of travel on transfer are exempt. Expenses granted to meet cost of travel on transfer and cost of packing and transportation of personal effects on such transfer are exempt.

Use of employer's vehicle or transport provided for journey of employee from residence to his place of work and back is not treated as perquisite and its cost is not treated as income.

Refreshments during office hours to employees and recreational facilities provided to group of employees are not treated as perquisites.

Income from House Property

Income from house property consists of buildings and/or lands appurtenant thereto. However, income only from vacant plot or land is treated as ‘income from other sources’. Following should be noted.

In case of let-out property, income will be ‘fair annual value’ i.e. sum reasonably expected to be received from letting or ‘actual rent received’ whichever is higher. Deduction is allowable for unrealized rent.

‘Annual Value or Property’ is the sum for which the property could reasonably be expected to let from year to year. Municipal Valuation of ratable value can be taken as one of the tests to determine *bona fide* value of the property. If the house property is given on rent, actual rent received will be the ‘annual value of the house property’.

From the ‘Annual Value of House Property’, in case of let out property, following will be allowed as deduction – (a) Municipal tax – The deduction will be permitted on actual payment basis (b) Standard deduction of 30% of (gross annual value less municipal tax) [section 24(a) of Income Tax Act] (c) Interest on capital borrowed to acquire or construct the house property subject to limit explained below [section 24(b) of Income Tax Act]

Annual Value of a self-occupied property is taken as ‘Nil’, if it is not let out. In such cases, none of the aforesaid expenses are allowed as deduction. However, if the self-occupied property is acquired or constructed or repaired from borrowed funds, interest payable on such funds upto Rs 1,50,000 per annum is allowed as deduction. Interest on borrowed capital for repairs is allowable as deduction upto Rs 30,000.

Naturally, this will be a ‘loss’ as the annual value of self occupied property is ‘Nil’. This ‘loss’ can be set off against any other income of the assessee. In other words, if funds are borrowed to acquire or construct or repair self-occupied property, interest upto Rs 1,50,000/30,000 paid per annum is allowable as deduction from any other income.

House property or any portion thereof occupied by the owner for purpose of his business or profession is excluded and any expense of current repairs, municipal taxes, depreciation on property etc. is allowable as business expenditure.

Profits and Gains of Business or Profession

Profit and gains of business as specified in section 28 of Income tax Act are taxable.

The term ‘business’ includes trade, commerce or manufacture or adventure or concern in nature of trade, commerce or manufacture [section 2(13) of Income Tax Act]

‘Professional Income’ is income from exercise of any profession or vocation which calls for an intellectual or manual skill. It covers doctor, lawyers, accountants, consulting engineers, artists, musicians, singers etc.

Profits of business or gains from profession are calculated after allowing all legitimate business expenditure. Some important deductions admissible in computing income from business or profession are as follows [sections 30 to 36 of Income Tax Act] —

* Rent, rates, taxes, repairs and insurance for business or professional premises [section 30 of Income Tax Act]

* Current repairs and insurance of machinery, plant and furniture [section 31 of Income Tax Act]

* Depreciation on building, machinery, plant or furniture [section 32 of Income Tax Act] (discussed below)

* Revenue expenditure on scientific research [section 35(1) of Income Tax Act]

* Capital expenditure on scientific research related to business (except land) [section 35(2) of Income Tax Act]

* Preliminary expenses in relation to formation of a company or in connection with extension of an undertaking or setting up of a new industrial unit can be amortised in 5 equal installments over 5 years. The preliminary expenditure is permitted only upto 5% of cost of project [section 35D]

* Insurance expenses [section 36(1)(i) of Income Tax Act]

* Insurance premium on health of employees [section 36(1)(ib) of Income Tax Act]

* Bonus or commission to employees [section 36(1)(ii) of Income Tax Act]

* Interest on borrowed capital [section 36(1)(iii) of Income Tax Act]

* Contributions towards approved provident fund, superannuation fund and gratuity fund [section 36(1)(iv) and 36(1)(v) of Income Tax Act]

* Bad debts in respect of income considered in previous years can be written off and allowable as deduction [section 36(1)(viii) of Income Tax Act]

* Banking cash transaction tax [section 36(1)(xiii) of Income Tax Act]

* Advertisement expenditure is fully allowed as deduction. However, expenditure incurred on advertisement in any souvenir, brochure, pamphlet etc. of a political party is not allowed as a deduction [section 37(2B) of Income Tax Act]

* Expenditure in maintenance of guest house is permissible as deduction [section 36(1)(i) of Income Tax Act]

* Any other expenditure which is not of capital nature or personal expenses of the assessee is allowed if it is expended wholly and exclusively for the purposes of business or profession. However, it should not have been for purpose which is an offence or is prohibited by any law [section 37 of Income Tax Act]

5-1 ***Depreciation*** - Depreciation means diminution in value of an asset on account of wear and tear and obsolescence.

In any business, raw material is used fully and immediately, while plant and machinery is used slowly over a period of time. After the estimated life of machinery, its value becomes Nil. Hence, it is fair that cost of machinery is charged over the period of its estimated useful life. This is the basic principle of depreciation on capital goods. Since land does not depreciate, no depreciation is allowed on land.

Under Income Tax, depreciation is calculated on the basis of 'block of assets'. 'Block of assets' means a group of assets falling within a class of assets, in respect of which the same % of depreciation rate has been prescribed. e.g. all machinery having rate of depreciation as 25% will form one block of asset, machinery having 40% rate of depreciation will form another 'block of asset' and so on.

Depreciation is allowed on actual cost of the asset. Interest paid on borrowed funds and capitalised as pre-commencement expenses before the asset is commissioned is added to cost of the asset and depreciation claimed on such expenditure. Thus, pre-production expenditure can be included in cost of the machinery and depreciation can be charged on such 'actual cost'. In *Chellapalli Sugar* v. *CIT* AIR 1975 SC 97 = 98 ITR 167 (SC), it as held that it includes all expenditure necessary to bring such asset into existence. [Thus, it will include installation charges]. It was held that interest on loans upto date of commencement of business forms part of 'actual cost' of plant for purpose of depreciation.

Depreciation is calculated on Written Down Value (WDV) method. If the asset is put to use for purpose of business for less than 180 days, only 50% of normal depreciation is permissible. In other words, full depreciation for the year is permissible only if asset is commissioned before 30th September of that year.

If depreciation cannot be fully claimed in a particular year for want of profits, the un-absorbed depreciation can be carried forward for any number of succeeding assessment years. [section 32(2)].

The depreciation rates in respect of some important assets are as follows :

* Residential building – 5%. Others (including hotels and boarding houses) – 10%. Purely temporary structures – 100%.

* Furniture and fittings including electrical fittings – 10%

* Motor cars 15% . Buses, lorries, and taxis used in business of running them on hire – 30%,

* Pollution control equipment and specified energy saving devises - 100%

* General machinery - 15%, aeroplane – 40%, Ships – 20%

* Computers including software - 60%.

* Books by professionals – 100% for annual subscription and 60% for others - books in library - 100%.

* Intangible assets - know-how, patents, copyrights, trade marks, licenses, franchises or any other right of similar nature - 25%.

In *Mysore Minerals* v. *CIT* 1999 AIR SCW 3146 = 1999(5) SCALE 340 = 239 ITR 775 = AIR 1999 SC 3185 = 106 Taxman 166 (SC), it was held that claimant of depreciation need not be owner of asset in legal sense. Person in whom for the time being vests the dominion over the asset and who is entitled to use it in his own right is eligible to claim depreciation. – followed in *Dalmia Cement* v. *CIT* 2000 AIR SCW 4198 (SC 3 member bench).

However, if assessee has not acquired dominion over the asset, he will not be entitled to depreciation on that asset. – *Tamilnadu Civil Supplies* v. *CIT* (2001) 116 Taxman 369 = 2001 AIR SCW 4777 (SC 3 member bench).

Depreciation compulsory – As per Explanation 5 to section 32(1)(ii), inserted w.e.f. 11.5.2001, depreciation is compulsory in computing total income even if assessee had not claimed the same. This amendment applies to AY 2002-03 onwards. [In *CIT* v. *Mahendra Mills* (2000) 2 SCALE 384 = AIR 2000 SC 1960 = 243 ITR 56 = (2000) 109 Taxman 225 (SC), it was held that assessee has option to claim or not to claim depreciation. The depreciation cannot be thrust upon him. Now, this judgement is ineffective from AY 2002-03]

Depreciation in case of imported machinery obtained on loan in foreign currency – If machinery is imported on loan repayable in foreign currency, the amount payable in rupees will go on changing due to fluctuations in foreign exchange rates, as the installments and interest are spread over a period. In such case, the value of machinery should be increased on basis of entire loan outstanding and not merely installments of loans that fell due during the accounting period. – *CIT* v. *Arvind Mills* (1992) 193 ITR 255 = 60 Taxman 192 (SC) – quoted and followed in *CIT* v. *Madras Fertilizers* (2002) 124 Taxman 581 (Mad HC DB).

5-2 *Expenditure not allowed as deduction*

Following expenditures are not allowed as deduction for purpose of income tax.

Deduction of taxes, interest etc. Only on actual payment basis - Tax, duty, cess, fees payable under any law, Employer's contribution to provident fund or ESIC, bonus to employees, commission to employees, interest on any loan or borrowing from financial institutions, banks, SFC, leave encashment are eligible as deduction only if they are paid on 'due dates' on which these were payable. Even if these are not paid on due dates but are paid before filing of return, these are allowed as deduction, if proof of payment is filed along with the return. However, in case of employer's contribution to provident fund, superannuation fund or gratuity fund, the same is allowed as deduction only if it was paid before due date of payment [section 43B of Income Tax Act]

Expenditure in excess of Rs 20,000 in cash fully disallowed - If expenditure is incurred in business or profession by payment of cash over Rs 20,000 in a day, entire expenditure is disallowed [Earlier, 20% of such expenditure was disallowed upto AY 2007-08]. All cash transactions in a day to a party should not exceed Rs 20,000. [Till 31-3-2008, each transaction was considered for the limit of Rs 20,000. Now, total transactions in a day will be considered [section 40A(3) of Income Tax Act]

Payment over Rs 20,000 should be made by cheque or demand draft. This restriction is not applicable in case of payments to # RBI, other banks and financial institutions, LIC # Government payments, payment by book adjustment, railway freight * Payment for agricultural produce, poultry, fish etc. to the cultivator, grower or producer (i.e. payments to middlemen are not excluded from this provision) [rule 6DD]

Similarly, a person can accept loans or deposits of Rs 20,000 or more only by account payee bank draft or cheque.

Interest on delayed payment to small industries - Interest on delayed payment made to Small Scale Industries is not allowable as deduction.

Expenditure for any purpose which is an offence in law - Section 37(1) of Income Tax Act states that any expenditure incurred for any purpose which is an offence or which is prohibited by law shall not be allowed as deduction.

5-3 ***Different accounting for balance sheet and income tax purposes*** - Method of depreciation, valuation of stock etc. is different under Companies Act and Income Tax Act. Hence, one method of accounting for income tax and other for Companies Act is permitted. The practice has been specifically approved in *United Commercial Bank* v. *CIT* 1999 AIR SCW 4050 = AIR 2000 SC 94 = 106 Taxman 601 (SC).

Accounting profits and assessable profits are conceptually different. – *CIT* v. *Bipinchandra Maganlal* (1961) 41 ITR 290 (SC).

Other important provisions in respect of business income

6 Some important provisions in relation to income from business or profession are as follows -

Maintenance of books of account - In respect of professional in legal, medical, engineering, architecture, accountancy or technical consultancy must maintain books, if their gross receipts are less that Rs 1.50 lakhs, they have to maintain such books of account as may enable Income Tax Officer to compute their taxable Income. If their gross receipts exceed Rs 1.50 lakhs, they have to maintain books of account as specified in rule 6F i.e. cash book, journal, ledger, copies of bills exceeding Rs 25 issued by him, original bills in respect of expenditure and payment vouchers etc. Person carrying on medical profession has to maintain additional books as prescribed. [Section 44AA and rule 6F]

Persons carrying on business or professionals other than those mentioned above have to maintain books of accounts if annual income exceeds Rs 1,20,000 or gross receipts or turnover exceed Rs. ten lakhs in case of business also have to maintain books of account.

Accounts on mercantile or cash basis - Accounts should be maintained either on mercantile basis or cash basis. Hybrid i.e. mixed system is not permitted. [In cash system, income or expenditure is considered only when it is actually received / paid. In mercantile system, income/expenditure is considered on accrual and payable basis. Actual receipt or payment may occur in subsequent financial year and may not happen in that particular year.]

Income tax audit report - If gross receipts or turnover of business exceeds Rs 40 lakhs per annum, the accounts have to be compulsorily audited. In case of professional income, accounts have to be audited if gross receipts exceed Rs ten lakhs. This audit report should be submitted along with income tax return, before 30th September. [section 44AB].

Capital Gains

Capital Gains

Capital gains means any profit or gains arising from transfer of a capital asset. Such capital asset may be building, non-agricultural land, machinery, shares, jewellery etc. However, stock in trade, agricultural land in rural area and personal effects (other than jewellery) are not ‘capital assets’.

From AY 2008-09, archaeological collections, paintings, sculptures will not be treated as ‘capital assets’.

Broadly, ‘capital gain’ is the difference between the price at which the asset was acquired and the price at which the same asset was sold. In technical terms, capital gain is the difference between cost of acquisition and the full value of consideration. Incidental expenditure and cost of improvement is allowable as deduction.

The ‘cost of acquisition of capital asset’ is to be increased by Cost Inflation Index. The index is announced by Central Government every year. The index was 100 for 1981-82, 172 for 1989-90, 244 for 1993-94, 331 for 1997-98, 351 for 1998-99, 389 for 1999-2000, 406 for 2000-01, 426 for 2001-02, 447 for 2002-03, 463 for 2003-04 and 480 for 2004-05, 519 for 2006-07, 551 for 2007-08, 582 for 2008-09 and 632 for 2009-10.

The cost of acquisition will be adjusted on basis of the above index and then capital gain will be calculated. The formula is Cost of acquisition x Cost Inflation Index of the year in which the asset is transferred / Cost Inflation Index of the year of acquisition. If the asset was acquired before 1.4.1981, the Cost Inflation Index of that year will be treated as 100. Thus, if an asset was brought in 1989-90 for Rs one lakh and sold in 1997-98 for Rs three lakhs, the adjusted cost of acquisition will be (1,00,000 x 331)/172 i.e. Rs 1,92,442, and capital gains will be Rs 1,07,558 (3,00,000 - 1,92,442). *Such adjustment is permissible only for long term capital gains and not for short term capital gains.*

Expenditure incurred on any improvement in asset is permitted as deduction and that cost can also be adjusted on the same principles as above.

If a company issues bonus shares, the cost of acquisition of bonus shares will be treated as ‘Nil’. Thus, if the bonus shares are sold, net sale proceeds of bonus shares will be liable to capital gains.

Expenditure incurred in connection with transfer (like stamp duty, registration charges, legal fees, brokerage etc.) are allowed as deduction. Capital gain is charged as income of the financial year in which the transfer took place.

Capital gain can be classified as ‘short term’ or ‘long term’. A short term capital gain is when the asset was held by the assessee for a period of upto 36 months. If the asset was held for more than 36 months, the gain will be long term gain. The period is only 12 months (instead of 36 months) in case of shares or any other security listed in stock exchange or units of UTI or units of mutual fund.

The income tax rate is 20% on long term capital gains, while calculating the long term capital gains, indexation of purchase price is required. *Tax on long term capital gain shall be subject to ceiling of 10% of capital gains calculated without indexing.*

The short term gains are added in other income of the assessee and the income tax is payable according to the normal rate applicable to the assessee.

In case of short term gains covered under section 111A of Income Tax Act , the rate is 10% for AY 2008-09 and 15% for Assessment Year 2009-10 onwards. Section 111A is applicable in respect of securities transactions which are subject to securities transaction tax.

Capital gains arising from sale of residential house is exempt if the original asset (i.e. the house) was held for more than three years and a new house was purchased within one year before or two years after the sale of original asset, or a new residential house is constructed within three years. The cost of new asset (residential house) should be more than the amount of capital gains [section 54 of Income Tax Act]

Any other long term capital gain is exempt if the capital gains are invested within 6 months in 3 year bonds issued by REC or NHAI and that investment is retained for three years. Investment cannot exceed Rs 50 lakhs - section 54EC of Income Tax Act.

Income from Other Source

Income from other sources

All income other than income from salary, house property, business and profession or capital gains is covered under ‘Income from other sources’. Provisions in respect of some important sources of ‘other income’ are summarised below.

Dividends - Dividends on shares of domestic companies or units of UTI or mutual fund received from a company on or after 1-4-2003 will not be taxable at the hands of the assessee [section 10(34) and 10(35)]. [The dividend distribution tax (DDT) will be payable by company/mutual fund u/s 115-O] However, deemed dividend as defined in section 2(22) of Income Tax Act will be considered as ‘income from other sources’.

Winning from lotteries, races etc. - Winning from lotteries, card games, horse races are taxable as other income. This is taxable @ 30.3% without claiming any allowance or expenditure.

Interest on securities, bank deposits and loans - Interest on bank deposits and loans is treated as ‘other income’, if not taxable u/s 28.

Gifts - Gifts in a year exceeding Rs 50,000, except gifts from certain relatives and gifts on certain specified occasions will be taxable [section 56(2)(vi) of Income Tax Act]

Income from letting - Income from letting of furniture, machinery, plant and building which is not separable fro, composite letting with machineries is taxable as other income. Current repairs, insurance and depreciation are allowed as deductions [section 56(2)(ii) and (iii) of Income Tax Act]

Rebate / Exemption from Income Tax Liability

9 Following rebates / exemptions are available.

9-1 ***Deductions under chapter VI-A and rebates***

Investments and deposits - Investments in PPF, Provident Fund, LIC, repayment of housing loans, NSIC, 5 year FDR with scheduled banks, 5 year time deposit in post office, deposit in Senior Citizens Saving Scheme etc. are allowed as deduction upto Rs 1,00,000 u/s 80C.

***Deduction of medical insurance premium, pension fund* -** Following deductions are permissible - (a) Medical insurance premium upto Rs 20,000 for senior citizen and Rs 15,000 for others. For the Assessment Year 2009-10, additional deduction of Rs 15,000 will be allowed if insurance policy of parents is taken (section 80D). (b) Contribution to pension fund within overall ceiling of Rs one lakh (section 80CCC)

Donations - Contribution to approved charitable institutions - in some cases 50% of amount paid is allowed as deduction, while in some cases, 100% amount paid is allowed as deduction (section 80G).

Exemption to EOU, SEZ - Income In case of EOU, STP, EHTP and BTP, the concession will continue upto 31-3-2010. In case of SEZ, exemption is for larger period.

Other provisions of Income Tax

10 Certain other important provisions of income tax are discussed here.

10-1 ***Clubbing of Income*** - Often salary or other expenses from business are shown in name of close relatives like spouse (wife / husband) or minor child, to reduce tax liability. In such case, if the individual has a substantial interest in the concern, the income of such wife, husband or minor child will be added to the income of such individual. This is termed as ‘clubbing of income’.

The clubbing provision is not applicable if spouse possesses technical or professional qualifications and the income is solely due to application of his / her technical knowledge and experience [section 64(1)(ii) of Income Tax Act]

If an asset is transferred to the spouse, income from such asset is also treated as income of the individual. [e.g. by transferring shares, house property etc.].

Similarly, if an individual throws his separate property into the property of HUF, income from such converted property will be included in the total income of such individual [section 64(2) of Income Tax Act]

The clubbing provision has obviously been made to plug avoidance of income tax liability, by ‘showing’ some income in the name of spouse / minor child / HUF.

10-2 ***Set off and carry forward of loss***

Carry forward of loss other than speculation loss - Carry forward of loss is permitted only when return is filed in time. In case of closely held company, unabsorbed loss can be carried forward only if at least 51% of shares are held beneficially by same persons who were holding them in previous year.

Unabsorbed depreciation - Unabsorbed depreciation can be set ff against any head of income other than salary. It can be carried forward to any number of years. It can be carried forward by same assessee except in case of amalgamation, demerger and business reorganization.

Speculative loss - Loss from speculative transactions involves sale and purchase of commodities including stocks and shares. It can be set off against speculative profits only and can be carried forward for four years.

10-3 ***Permanent Account Number*** - Every person whose total sales, turnover or gross receipts are over Rs 5,00,000 are required to apply and obtain a Permanent Account Number (PAN) [section 139A].

Any other person can obtain PAN voluntarily.

In addition, ITO can allot PAN *suo moto* to a person by whom income tax is payable.

Government has decided to use PAN as a common business identification number to be used by various agencies and departments like customs, excise, DGFT, SEBI etc.

10-4 ***Advance Income Tax*** **-** Tax is deducted from salary payable to an employee. Since a businessman or professional earns his own income, there is no TDS (Tax Deduction at Source). Hence, he is liable to pay advance tax as he earns income. This is 'Pay Tax as you Earn'. Thus, advance tax is payable on the basis of estimated income of the current financial year. [The income is 'estimated' because, actual income will be known only after the financial year is over].

Advance tax is payable only in cases where tax payable is in excess of Rs 10,000 (the limit was Rs 5,000 upto 31-3-2009). The assessee has to pay advance tax on his own accord and no notice will be issued to him. The advance tax is payable in installments as follows -

In case of company - # 15% on or before 15th June # 30% on or before 15th September # 30% on or before 15th December # Remaining 25% on or before 15th March. If there was shortfall in earlier installment, it should be made up in subsequent installment.

* ***In case of partnership firms, proprietors, professionals etc***. - # 30% on or before 15th September # 30% on or before 15th December # Remaining 40% on or before 15th March. If there was shortfall in earlier installment, it should be made up in subsequent installment.

Thus, 100% income tax in respect of estimated income of current financial year is payable by 15th March. If any instalment is not paid on due date, it can be paid subsequently.

If advance tax is not paid or short paid on due dates, mandatory interest is payable as follows :

* If advance tax was not paid before 31st March of the financial year, or advance tax paid was less than 90% of the assessed tax, interest @ 1% per month or part thereof is payable from 1st April till the month of payment. [section 234B]. The interest is not payable if total tax liability is less than Rs 5,000 or if at least 90% of assessed tax was paid before 31st March.

* If installments of advance tax are not paid on due dates, interest on shortfall is payable @ 1% per month. In case of last instalment which is due on 15th March, interest @ 1% is payable for one month if tax is not paid at all or is paid after 15th March. [section 234C]. Note that this interest is calculated only upto 31st March, as from 1st April, interest @ 1% becomes payable on entire tax due under section 234B.

This interest is mandatory and there is no provision to grant exemption form payment of this interest.

If the return is not filed within due date, interest @ 1% is payable u/s 234B. In addition, interest @ 1% is payable u/s 234A. Thus, if return is not filed on or before due date, interest payable is 2% for every subsequent month.

10-5 *Special provisions in respect of Partnership firm*

A partnership firm is presently assessed on the lines similar to the assessment of a company. The firm can pay salary and interest on capital to the partners. Income tax is payable on profits calculated after deducting salary and interest paid to partners. The salary paid to partners is treated as 'business income' in their hands and is taxable accordingly.

The partnership firm may or may not be registered. However, the partnership must be evidenced by a partnership deed. The deed should indicate * individual shares of the partners * Salary payable to working partners * Interest payable to partners. A true copy of partnership deed certified and signed by all the partners should be filed along with the first return of income. Subsequently, the copy is not required to be filed along with every return. However, if there is any change in the partnership agreement, a fresh copy has to be filed.

Return of partnership firm can be signed by managing partner.

Salary to working partners - The salary payable to partners is as follows -

The salary can be paid only to working partners. Such payment should be authorised by partnership deed. This salary is allowed as deduction from income of the partnership firm and is taken as business income of the individual partner. Salary allowable as deduction w.e.f. 1-4-2009 is as follows –

As per section 40(b) of Income Tax Act, maximum amount deductible in respect of remuneration to partner is as follows, w.e.f. 1-4-2009 – (**a**) If book profit is negative or less than Rs 1,66,667– Rs 1,50,000 (**b**) If book profit is Rs 1,66,667 or more – On first 3 lakhs 90% and on balance 60%.

The amount deductible from income of partnership firm will be the amount given above or amount actually debited to profit and loss account of partnership firm, whichever is lower.

Remuneration paid/credited to partner will be allowable as deduction to firm and it will be taxed at the hands of partner of the firm.

Till 31-3-2009, the salary allowable was as follows -

* Professional partnership firms - # upto book profit of Rs 1,00,000 - 90% of book profit - minimum Rs 50,000 # On next Rs 1,00,000 book profit - 60% # On balance of book-profit - 40%.

* Other than professional partnership firms (i.e. business firms) - # upto book profit of Rs 75,000 - 90% of book profit - minimum Rs 50,000 # On next Rs 75,000 book profit - 60% # On balance of book-profit - 40%.

The salary can be paid only to working partners. Such payment should be authorised by partnership deed. This salary is allowed as deduction from income of the partnership firm and is taken as business income of the individual partner.

Interest to partners - Income Tax Act provides that interest upto 12% paid to the partners will be allowable as deduction from income of partnership firm [section 40(b)((iv) of Income Tax Act]. [The interest rate was 12% upto 31-5-2002]. Such payment should be authorised by partnership deed. This interest is allowed as deduction from income of the partnership firm and is taken as 'other income' of the individual partner.

10-6 *Tax deduction at source (TDS)*

A person is under liability to deduct income tax at source and pay it to Government. He should issue a certificate to the person from whom tax is deducted, so that the person can submit the same to Income Tax authorities. Tax deducted at source should be paid to Government within one week from date of deduction. At the end of the year, a return in prescribed form has to be filed with ITO.

TDS is rightly called 'tedious', but not deducting tax at source can invite penalties.

As can be seen from following, if the person making payment is individual or HUF, he is exempt from the provisions of TDS in most of the cases, if he is not required to submit income tax audit report u/s 44AB. However, TDS provisions apply to (a) salary payments made by an individual or HUF even if he is not required to submit any income tax audit report u/s 44AB (b) If the individual/HUF is required to submit Income Tax Audit report.

TDS from salary - Every employer has to deduct tax from salary of employees. Payer should calculate tax payable on salary at the [section 192].

While deducting tax at source, the employer can consider the investments made by employee which qualify for exemption, payment for purchase or construction of house, mediclaim insurance premium etc. Income tax is to be deducted every month and should be paid to Government within a week after deduction. The employer can adjust deductions from month to month so that total deductions from salary of the whole year is equal to tax payable by employee on salary income.

Deduction under section 80G is not to be considered by employer (except some specified funds like PM Relief Fund etc.) while calculating tax liability of employee. The tax relief has to be claimed by employee through tax return.

The employer has to file an annual return of tax deducted at source from all employees.

TDS from Interest other than interest on securities - Tax should be deducted from interest paid if interest payable in financial year exceeds Rs 10,000 in case of banks, post office and cooperative society and Rs 5,000 in case of others [section 194A].

TDS during financial year 2009-10 is @ 10%. There is no surcharge or education cess.

If the deductee (person entitled to receive the amount on which tax is deductible) does not furnish his PAN number, TDS will be @ 20% w.e.f. 1-4-2010 [section 206AA of Income Tax Act] (what happens if he gives incorrect PAN number?]

During financial year 2008-09, TDS provisions were as follows - If recipient is a resident other than domestic company, TDS was as follows - (a) If recipient is individual/HUF/AOP where aggregate payment or credit is upto Rs 10 lakhs, cooperative society, local authority, firm where aggregate payment or credit does not exceed Rs one crore - 10.3% (b) If recipient is individual/HUF/AOP where aggregate payment or credit exceeds Rs 10 lakhs, firm where aggregate payment or credit exceeds Rs one crore - 11.33%

If recipient is a domestic company, TDS rate was as follows - (a) If recipient is domestic company where aggregate payment or credit does not exceed Rs one crore - 20.6% (b) If recipient is domestic company where aggregate payment exceeds Rs one crore - 22.66%

An individual who is 65 years of age or above can get interest without deduction of tax at source, if he submits a self-declaration to the payer in duplicate, in form No. 15H. Others have to submit declaration in form 15G.

The payer has to submit one copy of declaration (form 15G/15H as applicable) to Commissioner of Income Tax under whose jurisdiction his tax is being assessed.

Individuals and HUF are required to deduct tax on interest payment, if they is required to submit income tax audit report u/s 44AB. Provisions of making payment of TDS do not apply to small HUF and individuals who do not have to submit income tax audit report.

TDS from Payments to contractors, sub-contractors and advertising contracts - TDS provisions apply if contract value exceeds Rs 20,000 for single payment or Rs 50,000 in aggregate for a financial year [section 194C].

TDS on contract (both advertising and other than advertising) w.e.f. 1-10-2009 is as follows – (a) 1% in case of individual or HUF (b) 2% in case of other than individual or HUF. There is no surcharge or education cess.

If the deductee (person entitled to receive the amount on which tax is deductible) does not furnish his PAN number, TDS will be @ 20% w.e.f. 1-4-2010 [section 206AA of Income Tax Act] (what happens if he gives incorrect PAN number?)

Upto 30-9-2009, TDS provisions were as follows - In case of contract other than advertising contract, TDS was at following rates - (a) If recipient is individual/HUF/AOP where aggregate payment or credit is upto Rs 10 lakhs, cooperative society, local authority , firm/domestic company where aggregate payment or credit does not exceed Rs one crore - 1.03% (b) If recipient is individual/HUF/AOP where aggregate payment or credit exceeds Rs 10 lakhs, firm/domestic company where aggregate payment exceeds Rs one crore - 1.133%

Upto 30-9-2009, in case of advertising contract, TDS was at following rates - (a) If recipient is individual/HUF/AOP where aggregate payment or credit is upto Rs 10 lakhs, cooperative society, local authority , firm/domestic company where aggregate payment or credit does not exceed Rs one crore - 2.06% (b) If recipient is individual/HUF/AOP where aggregate payment or credit exceeds Rs 10 lakhs, firm/domestic company where aggregate payment exceeds Rs one crore - 2.266%

TDS is also required to be deducted, if payment to contractors/sub-contractors is made by an individual or HUF, who is required to submit income tax audit report u/s 44AB. Provisions of making payment of TDS do not apply to small HUF and individuals who do not have to submit income tax audit report.

TDS from payment on advertising contracts - See above. Provision of TDS applies when client makes payment to advertising agency and not when advertising agency makes payment to the media i.e. print media or electronic media.

TDS from contractor in transport business - TDS from contractor or sub-contractor in transport business is Nil. However, if the transporter does not furnish his PAN number, TDS will be @ 20% w.e.f. 1-4-2010 [section 206AA of Income Tax Act] (what happens if he gives incorrect PAN number?]

TDS from commission / brokerage – TDS applies in respect of payment of commission or brokerage to resident. There is no TDS if commission / brokerage paid during the financial year is less than Rs 2,500. [section 194H]

TDS on commission or brokerage to a resident is 10% during financial year 2009-10. There is no surcharge or education cess.

If the deductee (person entitled to receive the amount on which tax is deductible) does not furnish his PAN number, TDS will be @ 20% w.e.f. 1-4-2010 [section 206AA of Income Tax Act] (what happens if he gives incorrect PAN number?]

Upto 31-3-2009, TDS was at following rates - (a) If recipient is individual/HUF/AOP where aggregate payment or credit is upto Rs 10 lakhs, cooperative society, local authority , firm/domestic company where aggregate payment or credit does not exceed Rs one crore - 10.3% (b) If recipient is individual/HUF/AOP where aggregate payment or credit exceeds Rs 10 lakhs, firm/domestic company where aggregate payment exceeds Rs one crore - 11.33%

TDS provisions are applicable, if payment of commission/brokerage is made by an individual or HUF, who is required to submit income tax audit report u/s 44AB. Provisions of making TDS payment do not apply to small HUF and individuals who do not have to submit income tax audit report.

TDS from Payments of Rent - TDS provisions apply if aggregate sum of rent paid exceeds Rs 1,20,000 per annum [section 194-I]

TDS w.e.f. 1-10-2009 is at following rates – Rent of plant and machinery – 2%. Rent of land or building or furniture or fitting – 10%.

If the deductee (person entitled to receive the amount on which tax is deductible) does not furnish his PAN number, TDS will be @ 20% w.e.f. 1-4-2010 [section 206AA of Income Tax Act] (what happens if he gives incorrect PAN number?]

Upto 30-9-2009, The TDS rates were varying between 10.3% to 22.66% depending on whether rent is for plant, machinery, land, furniture etc. and who is the recipient.

TDS provisions are applicable, if payment of rent is made by an individual or HUF, who is required to submit income tax audit report u/s 44AB. Provisions of making payment of TDS do not apply to small HUF and individuals who do not have to submit income tax audit report.

TDS from Payments for professional or technical services - TDS provisions apply if aggregate sum paid for professional or technical services exceed Rs 20,000 per annum [section 194J]. TDS should be on total payment including reimbursement of expenses, as per CCBDT circular No. 715 dated 8-8-1995. However, in *ITO* v. *Dr. Willmar Schwabe* (2005) 3 SOT 71 (ITAT), it has been held that reimbursement of expenses for which bill is separately raised did not attract the provisions of section 194J.

TDS during financial year 2009-10 is @ 10%. There is no surcharge or education cess.

If the deductee (person entitled to receive the amount on which tax is deductible) does not furnish his PAN number, TDS will be @ 20% w.e.f. 1-4-2010 [section 206AA of Income Tax Act] (what happens if he gives incorrect PAN number?]

Upto 31-3-2009, TDS was at following rates - (a) If recipient is individual/HUF/AOP where aggregate payment or credit is upto Rs 10 lakhs, cooperative society, local authority , firm/domestic company where aggregate payment or credit does not exceed Rs one crore - 10.3% (b) If recipient is individual/HUF/AOP where aggregate payment or credit exceeds Rs 10 lakhs, firm/domestic company where aggregate payment exceeds Rs one crore - 11.33%

TDS provisions are applicable, if payment for professional or technical services is made by an individual or HUF, who is required to submit income tax audit report u/s 44AB. Provisions of making TDS payment do not apply to small HUF and individuals who do not have to submit income tax audit report.

TAN number – Assessee should obtain TAN (Tax Deduction Account Number) which is required to be quoted on all TDS returns. It is a 10 digit alphanumeric code.

TDS Return – Person who has deducted tax at source is required to file return to Income Tax department on annual basis. In case of companies, the return is to be filed on computer media, i.e. for them, filing of e-TDS is compulsory. The form has been prescribed. 'Electronic Filing of Returns of Tax Deducted at Source Scheme, 2003' has been notified by CBDT for this purpose. The return has to be filed in prescribed form in floppy. NSDL (National Securities Depository Ltd.) has been given task of handling e-TDS returns.

10-7 *No income tax clearance certificate*

Income Tax department has discontinued giving Income Tax Clearance Certificates for various purposes like filing tender, bidding contracts etc. No such certificate will be issued by Income Tax department. The contractors etc. should quote PAN – CBDT circular No. 2/2004 dated 10-2-2004.

Income Tax Returns

11 Every assessee should file an annual return in prescribed form. The prescribed forms are as follows -

Form No.	Applicable to	Details
ITR 1	Individuals	Salary (including pension and family pension) and interest
ITR 2	Individuals and HUF	Any income other than business income
ITR 3	Individuals and HUF	Who are partners in firm but not carrying on business or profession as proprietor
ITR 4	Individuals and HUF	Who are proprietors having income from business or profession
ITR 5	Firm, AOP, BOI	Including return of FBT
ITR 6	Companies except charitable companies claiming exemption u/s 11	Including return of FBT
ITR 7	Charitable trusts etc. including cases covered by section 139(4A) to 129(4D)	Including return of FBT

ITR 8	Persons liable to FBT	FBT return only
ITR-V	All except charitable trusts who have filed return electronically without digital signature	Verification form for persons who have filed return electronically but without digital signature

The income tax return is really a self assessment memorandum. The assessee should calculate the tax and interest payable by him and pay it by challan. The payment will of course be after deducting the advance tax which he might have already paid.

E-return – Beginning has been made in 2003 for electronic filing of return under Electronic Furnishing of returns of Income Scheme, 2003. Filing of e-return is compulsory for corporate employees.

Due dates for filing return - The due dates for filing return are as follows -

* (a) Individuals having only salary income (b) Non-corporate assessees (Individuals, HUF, partnership firms or societies) having income from business or profession but who do not have to get their accounts audited under Income Tax or any other law - 31st July

* (a) Non corporate assessees (Individuals, HUF, partnership firms or societies) having income from business or profession and who have to get their accounts audited (b) A working partner where the firm in which he is a working partner has to get its accounts audited (c) Corporate Assessee (d) Persons who have to file return under one by six scheme – 30th September (Till 2007, it was 31st October).

The dates are mandatory and there is no provision to extend the due date. If the return is filed beyond due date, mandatory interest @ 1% per month of tax due is payable. Belated return upto one year beyond due date is permissible. Mandatory interest is payable, but no penalty is payable. Thus, if no tax was due, belated return upto one year can be submitted without payment of any interest.

A loss return must be filed in time. Otherwise, the carry forward of loss is not permitted. However, CBDT can grant extension for submitting return by a loss making company.

Signature on return - The return should be signed by individual, karta of HUF, managing partner, managing director etc. In some cases, return can be signed by authorised representative.

No intimation will be sent by Income Tax Officer, if any tax / interest / refund is not due on the basis of return of income / wealth filed.

Correction of arithmetical mistakes and incorrect claims – Arithmetical mistakes and incorrect claim apparent from the return can be corrected by department and intimation sent to assessee within one year from end of financial year in which return is made [section 143(1) amended vide Finance Act, 2008]. If no such intimation is made, acknowledgment of return will be deemed to be an intimation.

Scrutiny of returns - Some of the returns are taken by ITO for detailed scrutiny. Notice for scrutiny has to be served within 6 months from close of financial year in which return is furnished i.e. by 30th September. The ITO can require assessee to attend his office or produce evidence in support of the return filed [section 143(2) of Income Tax Act – section 115WE(2) in respect of FBT]

Payment of tax - The advance tax and self-assessment tax should be paid vide prescribed challan. Facility of e-payment is available.

Fringe Benefit Tax

FBT has been removed w.e.f. 1-4-2009. Hence, following discussions are valid only upto AY 2009-10 i.e. upto 31-3-2009.

Employer gives various benefits to employees. The benefits which are individually given to employee can be identified with the particular employee and taxed in his hands. However, where benefits are given collectively and it is difficult to identify individual employee, these should be taxed at the hands of employer.

FBT (Fringe Benefit Tax) has been introduced with this idea in mind w.e.f. 1-4-2005 (AY 2006-07).

However, practically, some benefits which can be identified with individual employee are taxable under FBT. Similarly, some expenses incurred by employer which hardly benefit employees are also taxed under FBT.

1-1 *Who is 'employer'?*

Employer means a company; a firm; an association of persons or a body of individuals; a local authority; and every artificial juridical person, not falling within any of the above. However, "employer" does not include (*a*) a political party, or (*b*) a person who is eligible for exemption under section 10(*23C*) or registered under section 12AA of Income Tax Act [section 115W(a) of Income Tax Act]

Thus, a proprietary firm or HUF is not liable to pay FBT. Similarly, Central Government; a State Government and a political party is not 'employer' and not liable to pay FBT.

Fringe benefit tax will apply to foreign companies if it has employees based in India. Fringe benefit tax will apply to liaison offices of foreign companies in India if the liaison offices have employees based in India - CBDT Circular No. 8/2005 dated 29-8-2005.

1-2 *When FBT is payable?*

As per section 115WA(1), fringe benefit tax is applicable if — (a) Fringe benefits are provided or deemed to be provided (b) These are provided by an "employer" as defined in section 115W(a) and *(c)* These benefits are provided to his employees.

1-3 *Quantum of FBT*

FBT is in addition to income tax. FBT is payable by employer. FBT is calculated at the rate of 30 per cent on the "value" of fringe benefits. Surcharge is as follows – (a) In case of AOP/BOI -10% of tax if fringe benefit is above Rs 10 lakhs (b) In case of firm, company or artificial judicial person – 10% of tax irrespective of amount of fringe benefit (c) In case of non-domestic company – 2.5% and (d) In case of local authority and cooperative society - Nil.

In addition education cess @ 2% and SAH education cess @ 1% is payable.

Thus, total FBT payable is as follows, for Assessment Year 2008-09 and 2009-10 –

Employer is AOP/BOI and fringe benefit is upto Rs 10,00,000	30.9%
Employer is AOP/BOI and fringe benefit exceeds Rs 10,00,000	33.99%
Employer is cooperative society or local authority	30.9%
Employer is non-domestic company	31.6725%

Return of FBT – Return has to be filed by 30th September.

2 Meaning of Fringe Benefit

Fringe Benefits are defined in two parts - (a) Fringe Benefits as defined in section 115WB(1) (b) Deemed Fringe Benefits as defined in section 115WB(2).

Valuation of each fringe benefit is to be done as per provisions of section 115WC.

Perquisites taxable at hands of employees - Perquisites in respect of which tax is paid or payable by the employee are not taxable as perquisites under FBT.

Transport to employees to and from home - Free or subsidised transport or allowance provided by the employer to his employees for journeys by the employees from their residence to the place of work or such place of work to the place of residence will also not be taxable under FBT.

2-1 Defined fringe benefits

"Fringe benefits", as defined in section 115WB(1), means any consideration for employment provided by way of the following -

Privilege or facility to employees - It covers any privilege, service, facility or amenity, directly or indirectly, provided by an employer, whether by way of reimbursement or otherwise, to his employees (including former employees). If any amount is recovered from employee, it will be deducted.

Free or concessional ticket for travel - It covers any free or concessional ticket provided by the employer for private journeys of his employees or their family members. It includes free or concessional tickets given by a transport undertaking to its employees and family members. It is not applicable if such tickets are given by an employer who is not engaged in the business of transport undertaking. Leave travel assistance or leave travel concession given by an employer to his employees is not covered by section 115WB(1)(*b*). In respect of transport facility provided by a transport undertaking to its employees, the value of fringe benefit shall be calculated at "cost" of which the same benefit is provided by the employer to the public as reduced by the amount, if any, paid by, or recovered from his employees. The cost at which the ticket is provided by the employer to the general public shall be the price of the ticket which an ordinary passenger is expected to pay on the date of purchase of the ticket for the date, time and the class of travel. Similarly, in a case where an open ticket is issued a number of days in advance but the reservation is generally confirmed a few hours before departure, the value of the free or concessional ticket shall be the cost of the ticket which an ordinary passenger seeking reservation a few hours before departure is liable to pay as reduced by the amount, if any, paid by or recovered from the employees - CBDT Circular No. 8/2005 dated 29-8-2005.

Contribution to superannuation fund - It covers contribution by the employer to an approved superannuation fund for employees. It may be noted that Employers' contribution to an approved superannuation fund is subject to fringe benefit tax. However, employers' contribution to gratuity fund/provident fund is not subject to fringe benefit tax. Value of fringe benefit will be 100% of amount in excess of Rs 1,00,000 for each employee. Thus, contribution upto Rs 1,00,000 per employee will not be considered as fringe benefit.

Security or sweat equity to employee - It covers any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or concessional rate to his employee and former employees. Value of fringe benefit will be 100% of fair market value of security or sweat equity on the date on which the option vests with the employee, less amount paid by employee.

Specified security includes employee's stock option. Tax will be on securities allotted under the option and not on option itself.

2-2 Deemed Fringe Benefits

Following benefits shall be deemed to have been provided by the employer to his employees if the employer has in the course of his business and profession incurred these expenses [section 115WB(2) of Income Tax Act]

Entertainment - 20% of expenditure will be considered as value of 'fringe benefit'. It includes the reimbursement of entertainment expenditure by an employer to employees/directors/others and also expenditure on meeting/ get-togethers of employees and their family members on non-festival occasions including annual day.

Provision of hospitality - 20% of expenditure will be considered as value of 'fringe benefit'. In case of hotels and carriage of passenger or goods by air/cargo, value of fringe benefits will be only 5%.

It covers provision of hospitality of every kind by the employer to any person, whether by way of provision of food or beverages or in any other manner whatsoever. It includes expenditure on food/meals incurred by employees and later on reimbursed by employer and expenditure on food and beverages provided by employer at a training centre taken on hire by employer. However, it does not include any expenditure on, or payment for, food or beverages provided by the employer to his employees in office or factory and any expenditure on or payment through paid vouchers which are not transferable and usable only at eating joints or outlets.

From Assessment Year 2009-10, it will not include pre-paid electronic meal cards issued to employees.

Conferences - 20% of expenditure will be considered as value of 'fringe benefit'. In case of construction, pharma and software industries, value of fringe benefit will be 5%.

It covers any expenditure on conveyance, tour and travel, on hotel, or boarding and lodging in connection with any conference shall be deemed to be expenditure incurred for the purposes of conference. It includes expenditure on attending training programmes organized by trade bodies and on conferences for agents/dealers/development advisor. However, it does not include the fixed conference allowance to employees/directors, fees for participation by employees in any conference (excluding travelling, boarding and lodging expenses) and expenditure on in house training of employees (excluding travelling, boarding and lodging expenses).

Sale promotion - 20% of expenditure will be considered as value of 'fringe benefit'. It covers sales promotion including publicity. It includes payment for use of brand/brand ambassador/celebrity endorsement but not payment to a person of repute for promoting sales. It expenditure on free offers (with products) such as freebies like tattoos, cricket cards or similar products, to trade or consumers, but does not include expenditure on free samples of products distributed to any person. Expenditure on product marketing research carried on through its own employees is includible.

It does not include the following - (a) Expenditure (including rental) on advertisement of any form in any print (including journals, catalogues or price lists) or electronic media or transport system (b) Expenditure on the holding of, or the participation in, any press conference or business convention, fair or exhibition (c) Expenditure on sponsorship of any sports event or any other event organized by any Government agency or trade association or body (d) Expenditure on the publication in any print or electronic media of any notice required to be published by or under any law or by an order of a court or tribunal (e) Expenditure on advertisement by way of signs, art work, painting, banners, awnings, direct mail, electric spectaculars, kiosks, hoardings, bill boards or display of products or by way of such other medium of advertisement (f) Expenditure by way of payment to any advertising agency for the above purposes (g) Brokerage and selling commission paid for selling goods (h) Expenditure relating to salesmen appointed by distributors for companies' products reimbursed through credit notes (i) Sale discount to wholesellers/customers or bonus points to customers (j) Expenditure on incentives given to distributors for meeting quantity targets (k) Expenditure on product marketing research paid to an outside agency (l) Expenditure in the nature of call centre charges for canvassing sales (cold calls) or carrying out post sales activities (m) Expenditure on making ad-film.

Employees' welfare - 20% of expenditure will be considered as value of 'fringe benefit'. Employees' welfare. It includes the following - (a) Payment for group personal accident/workman compensation insurance not under a statutory obligation (b) Medical expenditure reimbursement up to Rs. 15,000 (c) Expenditure on garden, site cleaning, light decoration etc. in employees colony (d) Expenditure on group health insurance not under a statutory obligation (e) Expenditure at a hospital/dispensary for injuries incurred during course of employment (hospital not run by employer) not under a statutory obligation (f) Subsidy provided to a school not meant exclusively for employees' children (g) Reimbursement of expenditure on books/periodicals to employees (h) Expenditure incurred on prizes/awards to employees (i) Expenditure on providing transport facility to employees' children (j) Expenditure on meeting/ get-togethers of employees and their family members on non-festival occasions including annual day.

This does not cover any expenditure incurred or payment made to fulfil any statutory obligation or mitigate occupational hazards or provide first aid facilities in the hospital or dispensary run by the employer. It also does not include medical facilities, reimbursement of medical expenses etc. which are not considered as perquisities of an employee.

From Assessment Year 2009-10, Employees' welfare will not cover (a) crèche facility for children of employees (b) Sponsorship of a sportsman who is employee and (c) Organise sports events for employees.

Conveyance - 20% is treated as Fringe Benefit. It includes (a) Reimbursement of car expenses including driver salary to employees on the basis of declaration or on the basis of bills submitted by employees (b) Travelling expenditure/conveyance expenditure/tour or travel expenditure incurred in respect of a project assigned by a client which is later on reimbursed by the client (c) allowances for meeting lodging and boarding given to employees.

It does not include Reimbursement of travelling expenditure/conveyance expenditure/tour or travel expenditure to a consultant in respect of a project assigned to him, fixed conveyance allowance/travelling allowance/transport allowance given to employees/director and expenditure for providing leave travel concession (LTC) to employees.

Hotel and lodging - 20% of expenditure will be considered as value of 'fringe benefit'. In case of carriage of passenger/goods by air/ship, pharma and software industries, value of fringe benefit will be 5%.

It covers use of hotel, boarding and lodging facilities. It includes any expenditure on use of hotel, boarding and lodging facilities. It also includes reimbursement of hotel bills to employees/directors. However, it does not include fixed hotel allowance to employees/directors

Repairs and maintenance of motor cars - 20% of expenditure will be considered as value of 'fringe benefit'. In case of carriage of passenger/goods by car business, value of fringe benefit will be 5%.

It covers repair, running (including fuel), maintenance of motorcars and the amount of depreciation thereon. It includes expenditure on repair of motor car, expenditure on running of motor car including fuel, maintenance expenditure of motor car, depreciation of motor car (as per Income-tax Act), lease rent of motor car, salary paid to drivers of motor cars, rent of garage for motor cars and interest on loan taken to purchase motor cars. However, it does not include any expenditure on running, maintenance of delivery vans, display vans, lorries, ambulances, tractors, buses, trucks, tempos, etc.

Repairs and maintenance of aircrafts - It covers repair, running (including fuel) and maintenance of aircrafts and the amount of depreciation thereon. It includes all expenses as applicable to repair and maintenance of motor cars. 20% of expenditure will be considered as value of 'fringe benefit'. In case of carriage of passenger/goods by air business, value of fringe benefit will be Nil.

Telephones - It covers use of telephone (including mobile phone) other than expenditure on leased telephone lines. 20% of expenditure will be considered as value of 'fringe benefit'.

Guest house accommodation - It covers maintenance of any accommodation in the nature of guest house (other than accommodation used for training purposes). 20% of expenditure will be considered as value of 'fringe benefit'. This has been excluded from fringe benefit from Assessment Year 2009-10.

Festival celebrations - It includes any festival celebration expenditure but does not include expenditure on celebration on Independence Day and Republic Day. 50% of expenditure will be considered as value of 'fringe benefit' for AY 2008-09 and 20% for AY 2009-10.

Use of health club and similar facilities - It includes reimbursement of health club expenditure to employees/directors and payment of entrance fees. It does not include depreciation on club building and fixed club allowance to employees/directors. 50% of expenditure will be considered as value of 'fringe benefit'.

Use of any other club facilities - It includes payment for entrance fees to a club and reimbursement of club expenditure to employees. 50% of expenditure will be considered as value of 'fringe benefit'.

Gifts - Gift may be in cash or kind. Even gifts on promotion of company's products to distributors/ retailers are covered under fringe benefit. 50% of expenditure will be considered as value of 'fringe benefit'.

Scholarships - It includes expenditure on training of employees in an educational institute. 50% of expenditure will be considered as value of 'fringe benefit'.

Tour, travel, foreign travel - 5% of expenditure will be considered as value of 'fringe benefit'.

3 Other provisions

Advertisement not as deemed benefit - The following expenditure on advertisement shall not be taken as "deemed fringe benefit" * the expenditure (including rental) on advertisement of any form in any print (including journals, catalogues or price lists) or electronic media or transport system * the expenditure on the holding of, or the participation in, any press conference or business convention, fair or exhibition * the expenditure on sponsorship of any sport event or any other event organized by any Government agency or trade association or body * the expenditure on the publication in any print or electronic media of any notice required to be published by or under any law or by an order of a court or tribunal * the expenditure on advertisement by way of signs, art work, painting, banners, awnings, direct mail, electric spectaculars, kiosks, hoardings, bill boards or by way of such other medium of advertisement * the expenditure by way of payment to any advertising agency for the purposes of above * the expenditure on distribution of free samples of medicines or of medical equipment, to doctors * the expenditure by way of payment to any person of repute for promoting the sale of goods or services of the business of the employer.

***No segregation of capital/revenue/preoperative expenses* -** All specified expenses are7 covered under fringe benefit, whether capital or revenue nature - CBDT Circular No. 8/2005 dated 29-8-2005.

***Fringe benefit is not allowable as expense under income tax but can be shown as expense in P&L account* -** For the purposes of computation of total income under the Income-tax Act, fringe benefit tax is not an allowable deduction by virtue of section 40(*a*)(*ic*). However, the accounting treatment of fringe benefit tax for the purposes of reporting to shareholders and complying with the obligations under the Companies Act will be governed by the Accounting Standards issued by the Institute of Chartered Accountants of India - CBDT Circular No. 8/2005 dated 29-8-2005.

FBT is deductible for computing book profit - The fringe benefit tax is an allowable deduction in the computation of 'book profit' under section 115JB - CBDT Circular No. 8/2005 dated 29-8-2005.

3-1 *Advance payment of fringe benefit tax*

Every employer shall pay advance tax on his current fringe benefits. The advance tax shall be payable on basis similar to one under which advance income tax is payable. The only difference is that advance FBT is payable even if tax is less than Rs 5,000.

Interest - For non-payment/short payment of advance fringe benefit tax, interest will have to be paid. The mode of computation of interest as provided in section 115WJ(3)/(4)/(5) is similar to the provisions regulating interest for non-payment or short payment of advance income-tax given in sections 234B and 234C.

4 Fringe Benefit Tax on ESOPs

The Finance Act,2007 has introduced FBT on ESOPs (Employees Stock Option Plan) w.e.f. Assessment Year 2008-09. The salient features of these provisions are:

(i)FBT shall apply in all cases where any specified security or sweat equity shares has been allotted or transferred by the employer to his employees;

(ii) FBT shall be payable in the previous year in which such allotment or transfer has taken place;

(iii)the provisions of this new clause shall apply irrespective of the allotment or transfer being direct or indirect;

(iv) the provisions of this new clause shall apply irrespective of the allotment or transfer being free of cost or at concessional rate;

(v) the provisions of this new clause shall apply irrespective of the allotment or transfer being to current or former employee or employees;

(vi) the provisions of this new clause shall apply in cases where the allotment or transfer is on or after 1st day of April, 2007.

(vii) the value of fringe benefit in such cases shall be determined in accordance with the formula

A-B

Where, A = the Fair Market Value (FMV) of the specified security or sweat equity shares on the date of vesting of the option; and

B = the amount, if any, actually paid by, or recovered from the employee;

FBT is payable only if A exceeds B. No FBT is payable where B exceeds A.

The expressions specified security and sweat equity shares have also been defined. The value of fringe benefit is subjected to FBT at the prevailing rate, which is currently 30% plus surcharge plus education cess.

The expression fair market value has been defined to mean the value determined in accordance with the method as may be prescribed by the Board. Option has been defined to mean a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price.

The Central Board of Direct Taxes (CBDT) vide notification S.O. No. 1805(E) dated 23rd October, 2007 has inserted Rule 40C in the income-tax Rules; which has prescribed the method for determination of fair market value of specified security or sweat equity share, being a share in the company. Salient features of this rule are:

(i)In a case where, on the date of the vesting of the option, the share in the company is listed on a recognized stock exchange, the fair market value shall be the average of the opening price and closing price of the share on that date on the said stock exchange;

(ii)If on the date of vesting of the option, the share is listed on more than one recognized stock exchanges, the fair market value shall be the average of opening price and closing price of the share on the recognised stock exchange which records the highest volume of trading in the share;

(iii) If on the date of vesting of the option, there is no trading in the share on any recognized stock exchange, the fair market value shall be,-

(a)the closing price of the share on any recognised stock exchange on a date closest to the date of vesting of the option and immediately preceding such date; or

(b) the closing price of the share on a recognised stock exchange, which records the highest volume of trading in such share, if the closing price, as on the date closest to the date of vesting of the option and immediately preceding such date, is recorded on more than one recognized stock exchange.

(iv)In a case where, on the date of vesting of the option, the share in the company is not listed on a recognized stock exchange, the fair market value shall be such value of the share in the company, as determined by a Category 1 Merchant Banker registered with the Security and Exchange Board of India, on the specified date.

(v) The specified date has been defined as to mean,-

(i) the date of vesting of the option; or

(ii) any date earlier than the date of the vesting of the option, not being a date which is more than 180 days earlier than the date of the vesting

Further, the Central Board of Direct Taxes has inserted a new rule 40D in the Income-tax Rules, vide notification S.O. No. 113(E), dated 18-012008, prescribing the method for determination of fair market value of specified security, not being an equity share in the company. Through the same notification, rule 40C has been amended to omit the definition of equity share.

A new section 115WKA has also been inserted enabling the employer to recover the fringe benefit tax from the employee in respect of specified security or sweat equity shares, if such security or shares are transferred or allotted to the employee on or after 1st April, 2007. It has been prescribed that the employer can vary the agreement or scheme under which such specified security or sweat equity shares has been allotted or transferred. The agreement or scheme can be varied with a purpose to recover from the employee the fringe benefit tax to the extent to which such employer is liable to pay the fringe benefit tax in relation to the allotment or transfer of such specified security or sweat equity shares to such employee.

Now, ESOP will be taxed in the hands of individual employee w.e.f. 1-4-2009, as FBT has been abolished.

Wealth Tax

Wealth tax

1 Introduction

Wealth tax is not a very important or high revenue tax in view of various exemptions. Wealth tax is a socialistic tax. It is not on income but payable only because a person is wealthy.

Wealth tax is payable on net wealth on ‘valuation date’. As per Section 2(q), valuation date is 31st March every year. It is payable by every individual, HUF and company. Tax rate is 1% on amount by which ‘net wealth’ exceeds Rs 30 lakhs from AY 2010-11. (Till 31-3-2009, the limit was Rs 15 lakhs). No surcharge or education cess is payable.

No wealth-tax is chargeable in respect of net wealth of any company registered under section 25 of the Companies Act, 1956; any co-operative society; any social club; any political party; and a Mutual fund specified under section 10(*23D*) of the Income-tax Act [section 45]

Net wealth = Value of assets [as defined in section 2(ea] plus deemed assets (as defined in section 4) less exempted assets (as defined in section 5), less debt owed [as defined in section 2(m)].

Debt should have been incurred in relation to the assets which are included in net wealth of assessee. Only debt owed on date of valuation is deductible.

In case of residents of India, assets outside India (less corresponding debts) are also liable to wealth tax. In case of non-residents and foreign national, only assets located in India including deemed assets less corresponding debts are liable to wealth tax [section 6].

Net wealth in excess of Rs. 15,00,000 is chargeable to wealth-tax @ 1 per cent (on surcharge and education cess).

Assessment year - Assessment year means a period of 12 months commencing from the first day of April every year falling immediately after the valuation date **[Section 2(*d*)]**

All.).

1-1 Assets

Assets are defined in Section 2(*ea*) as follows.

Guest house, residential house or commercial building - The following are treated as “assets” - (a) Any building or land appurtenant thereto whether used for commercial or residential purposes or for the purpose of guest house (b) A farm house situated within 25 kilometers from the local limits of any municipality (whether known as a municipality, municipal corporation, or by any other name) or a cantonment board [Section 2(ea)(i)]

A residential house *is* not asset, if it is meant exclusively for residential purposes of employee who is in whole-time employment and the gross annual salary of such employee, officer or director is less than Rs. 5,00,000.

Any house (may be residential house or used for commercial purposes) which forms part of stock-in-trade of the assessee is not treated as “asset”.

Any house which the assessee may occupy for the purposes of any business or profession carried on by him is not treated as “asset”.

A residential property which is let out for a minimum period of 300 days in the previous year is not treated as an "asset".

Any property in the nature of commercial establishments or complex is not treated as an "asset".

Motor cars - Motor car is an "asset", but not the following - (a) motor cars used by the assessee in the business of running them on hire (b) motor cars treated as stock-in-trade [Section 2(ea)(ii)]. In the case of a leasing company, motor car is an asset.

Jewellery, bullion, utensils of gold, silver, etc. [Section 2(ea)(iii)] - Jewellery, bullion, furniture, utensils and any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals are treated as "assets" [Section 2(ea)(ii)]

For this purpose, "jewellery" includes ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, and also precious or semi-precious stones, whether or not set in any furniture, utensils or other article or worked or sewn into any wearing apparel.

Where any of the above assets (*i.e.,* jewellery, bullion, utensils of gold, etc.) is used by an assessee as stock-in-trade, then such asset is not treated as "assets" under section 2(*ea*)(*iii*).

Yachts, boats and aircrafts - Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes) are treated as "assets" [Section 2(ea)(iv)]

Urban land - Urban land is an "asset" [Section 2(ea)(v)]

Urban land means land situated in the area which is comprised within the jurisdiction of a municipality and which has a population of not less than 10,000 according to the last preceding census.

Land occupied by any building which has been constructed with the approval of the appropriate authority is not 'asset'.

Any unused land held by the assessee for industrial purposes for a period of 2 years from the date of its acquisition by him is not an asset. Any land held by the assessee as stock-in-trade for a period of 10 years from the date of its acquisition by him is also not an asset.

Cash in hand - In case of individual and HUF, cash in hand on the last moment of the valuation date in excess of Rs. 50,000 is an 'asset'. In case of companies, any amount not recorded in books of account is 'asset' [Section 2(ea)(vi)]

1-2 Deemed assets

Often, a person transfers his assets in name of others to reduce his liability of wealth tax. To stop such tax avoidance, provision of 'deemed asset' has been made. In computing the net wealth of an assessee, the following assets will be included as deemed assets u/s 4.

Assets transferred by one spouse to another - The asset is transferred by an individual after March 31, 1956 to his or her spouse, directly or indirectly, without adequate consideration or not in connection with an agreement to live apart will be 'deemed asset' [Section 4(1)(a)(i)]

If an asset is transferred by an individual to his/her spouse, under an agreement to live apart, the provisions of section 4(1)(*a*)(*i*) are not applicable. The expression "to live apart" is of wider connotation and even the voluntary agreements to live apart will fall within the exceptions of this sub-clause.

Assets held by minor child - In computing the net wealth of an individual, there shall be included the value of assets which on the valuation date are held by a minor child (including step child/adopted child but not being a married daughter) of such individual [Section 4(1)(a)(ii)]

The net wealth of minor child will be included in the net wealth of that parent whose net wealth [excluding the assets of minor child so includible under section 4(1)] is greater.

Assets transferred to a person or an association of persons - An asset transferred by an individual after March 31, 1956 to a person or an association of person, directly or indirectly, for the benefit of the transferor, his or her spouse, otherwise than for adequate consideration, is 'deemed asset' of transferor [Section 4(1)(a)(iii)]

Assets transferred under revocable transfers - The asset is transferred by an individual to a person or an association of person after March 31, 1956, under a revocable transfer is 'deemed asset' of transferor [Section 4(1)(a)(iv)]

Assets transferred to son's wife [Section 4(1)(a)(v)] - The asset transferred by an individual after May 31, 1973, to son's wife, directly or indirectly, without adequate consideration will be 'deemed asset' of transferor [Section 4(1)(a)(iv)]

Assets transferred for the benefit of son's wife - If the asset is transferred by an individual after May 31, 1973, to a person or an association of the immediate or deferred benefit of son's wife, whether directly or indirectly, without adequate consideration, it will be treated as 'deemed asset' of the transferor [Section 4(1)(a)(vi)].

Interest of partner- Where the assessee (may or may not be an individual) is a partner in a firm or a member of an association of persons, the value of his interest in the assets of the firm or an association shall be included in the net wealth of the partner/member. For this purpose, interest of partner/member in the firm or association of persons should be determined in the manner laid down in Schedule III to the Wealth-tax Act [Section 4(1)(b)].

Admission of minor to benefits of the partnership firm - If a minor is admitted to the benefits of partnership in a firm, the value of his interest in the firm shall be included in the net wealth of parent of minor in accordance with the provisions of section 4(1)(*a*)(*ii*) [*see* para 546.2]. It will be determined in the manner specified in Schedule III.

Conversion by an individual of his self-acquired property into joint family property - If an individual is a member of a Hindu undivided family and he converts his separate property into property belonging to his Hindu undivided family, or if he transfers his separate property to his Hindu undivided family, directly or indirectly, without adequate consideration, the converted or transferred property shall be deemed to be the property of the individual and the value of such property is includible in his net wealth [Section 4(1A)]

If there was such transfer and if the converted or transferred property becomes the subject-matter of a total or a partial partition among the members of the family, the converted or transferred property or any part thereof, which is received by the spouse of the transferor, is deemed to be the asset of the transferor and is includible in his net wealth.

Gifts by book entries - Where a gift of money from one person to another is made by means of entries in the books of account maintained by the person making the gift, or by an individual, or a Hindu undivided family, or a firm or an association of persons, or a body of individuals with whom he has business connection, the value of such gift will be included in the net wealth of the person making the gifts, unless he proves to the satisfaction of the Wealth-tax Officer that the money had actually been delivered to the other person at the time the entries were made [Section 4(5A)]

Impartible estate - For the purpose of the Wealth-tax Act, the holder of an impartible estate shall be deemed to be the owner of all the properties comprised in the estate [Section 4(6)]

Property held by a member of a housing society - Where the assessee is a member of a co-operative housing society and a building or part thereof is allotted or leased to him, the assessee is deemed to be the owner of such building and the value of such building is includible in computing his net wealth. In determining the value of such building, any outstanding instalments, payable by the assessee to the society towards the costs of such house, are deductible as debt owed by the assessee. The above rules are also applicable if the assessee is a member of a company or an association of persons [Section 4(7)]

Property held by a person in part performance of a contract [Section 4(8)] - A person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882. Similarly, a person can acquire any rights, excluding any rights by way of a lease from month to month or for a period not exceeding one year, in or with respect to any building or part thereof, by virtue of transaction as is referred to in section 269UA(f) of the Income-tax Act.

In above cases, the assets are taxable in the hands of beneficial owners, in the same manner in which they are taxed under the Income-tax Act :

1-3 Assets which are exempt from tax

The following assets are exempt from wealth-tax, as per section 5.

Property held under a trust - Any property held by an assessee under a trust or other legal obligation for any public purpose of charitable or religious nature in India is totally exempt from tax. [Section 5(i)].

Business assets held in trust, which are exempt - The following business assets held by as assessee under a trust for any public charitable/religious trust are exempt from tax - (a) where the business is carried on by a trust wholly for public religious purposes and the business consists of printing and publication of books or publication of books or the business is of a kind notified by the Central Government in this behalf in the Official Gazette (b) the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the institution (c) the business is carried on by an institution, fund or trust specified in sections 10(23B) or 20(23C) of the Income-tax Act.

Any other business assets of a public charitable/religious trust is not exempt.

Coparcenary interest in a Hindu undivided family - If the assessee is a member of a Hindu undivided family, his interest in the family property is totally exempt from tax [Section 5(ii)].

Residential building of a former ruler - The value of any one building used for the residence by a former ruler of a princely State is totally exempt from tax [Section 5(iii)]

Former ruler's jewellery - Jewellery in possession of a former ruler of a princely State, not being his personal property which has been recognised as a heirloom is totally exempt from tax [Section 5(iv)]

The jewellery shall be permanently kept in India and shall not be removed outside India except for a purpose and period approved by the Board. Reasonable steps shall be taken for keeping that jewellery substantially in its original shape. Reasonable facilities shall be allowed to any officer of the Government, or authorised by the Board, to examine the jewellery as and when necessary.

Assets belonging to the Indian repatriates - Assets (as given below) belonging to assessee who is a person of Indian origin or a citizen of India, who was ordinarily residing in a foreign country and who has returned to India with intention to permanently reside in India, is exempt. A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand-parents, was born in undivided India.

After his return to India, following shall not be chargeable to tax for seven successive assessment years - (a) moneys brought by him into India (b) value of asset brought by him into India (c) moneys standing to the credit of such person in a Non-resident (External) Account in any bank in India on the date of his return to India and (d) value of assets acquired by him out of money referred to in (*a*) and (*c*) above within one year prior to the date of his return and at any time thereafter [Section 5(v)]

One house or part of a house - In the case of an individual or a Hindu undivided family, a house or a part of house, or a plot of land not exceeding 500 sq. meters in area is exempt. A house is qualified for exemption, regardless of the fact whether the house is self-occupied or let out. In case a house is owned by more than one person, exemption is available to each co-owner of the house [Section 5(vi)]

2 Valuation of assets

The value of an asset, other than cash, shall be its value as on the valuation date determined in the manner laid down in Schedule III.

Valuation of a building **-** Value of any building or land appurtenant thereto, or part thereof, is to be made in accordance with Part B of Schedule III to the Wealth-tax Act

The first step is to find out gross maintainable rent. Gross maintainable rent is (a) annual rent received/receivable by the owner or annual value of the property as assessed by local authority, whichever is higher (if the property is let out) or (b) annual rent assessed by the local authority or if the property is situated outside the jurisdiction of a local authority, the amount which the owner can reasonably be expected to receive as annual rent had such property been let (if the property is not let).

In the following cases "actual rent" shall be increased in the manner specified below : (a) Taxes borne by tenant (b) If property is rented, one-ninth of actual rent will be added, if expenditure on repairs in respect of the property is borne by the tenant (c) Interest @ 15% on deposit given by tenant or difference (d) Premium received as consideration for leasing of the property or any modification of the terms of the lease will be divided over the number of years of the period of the lease and will be added to 'actual rent' (d) If the derives any benefit or perquisite as consideration for leasing of the property or any modification of the terms of the lease), the value of such benefit or perquisite shall be added to actual rent.

Net maintainable rent is determined by deducting from the gross maintainable rent (a) the amount of taxes levied by any local authority in respect of property (deduction is available even if these are to be borne by the tenant) ; and (b) *A* sum equal to 15% of gross maintainable rent.

The net maintainable rent is finally capitalized to arrive as value of net asset.. This can be done by multiplying the net maintainable rent by 12.5. If the property is constructed on leasehold land, net maintainable rent is to be multiplied by 10 when the unexpired period of lease of such land is 50 years or more and multiplied by 8 where the unexpired period of lease of such land is less than 50 years).

If a property is acquired/constructed after March 31, 1974, then the value of the house property is determined as above. Original cost of construction/acquisition *plus* cost of improvement of the house property is calculated. The higher of the above is taken as capitalised value of net maintainable rent. This exception is applicable in respect one house property. The cost of acquisition/construction (*plus* cost of improvement) does not exceed Rs. 50 lakh, if the house is situated at Bombay, Calcutta, Delhi and Madras (Rs. 25 lakh at any other place).

If unbuilt area of the plot of land on which the property is built exceeds the specified area, premium is to be added to the capitalised value determined above.

Valuation of self-occupied property **-** If assessee owns a house (or a part of the house), being an independent residential unit and is used by the assessee exclusively for his residential purposes throughout 12 months ending on the valuation date, valuation will be as per provisions of section 7(2).

Assessee can either take value of the house as determined above on the valuation date relevant for the current assessment year or he take value of the house, as determined above, on the first valuation date next following the date on which he became the owner or the valuation relevant for the assessment year 1971-72, whichever is later. The choice is of the assessee.

Where the house has been constructed by the assessee, he shall be deemed to have become the owner thereof on the date on which the construction of such house was completed.

Valuation of assets of business **-** If the assessee is carrying on a business for which accounts are maintained by him regularly, the net value of the assets of the business as a whole, having regard to the balance sheet of such business on the valuation date, is taken as value of such assets [Part D, Schedule III].

(A) The assets are valued as follows - ***Depreciable assets*** - Written down value, plus 20%***, Non-depreciable assets (other than stock-in- trade)*** - Book value, plus 20%, ***Closing stock*** - Value adopted for the purpose of income-tax, plus 20%.

(B) Then value of house property, life interest, jewellery and other assets is calculated as per other provisions of Wealth Tax Act.

Higher of A or B is taken as value of assets.

Value of interest in firm or association of persons **-** The net wealth of the firm on the valuation date is ascertained.. For determining the net wealth of the firm (or association), no account shall be taken of the exemptions given by section 5. The portion of the net wealth as is equal to the amount of the capital of the firm or association is allocated amongst the partners or the members in the proportion in which capital has been contributed by them.

The residue of the net wealth is allocated amongst the partners or the members in accordance with the agreement of the partnership or association of persons for the distribution of assets in the event of dissolution of the firm or association or in the absence of such agreement, in the proportion in which the partners (or members) are entitled to share profits [Part E, Schedule III]

Value of life interest **-** The value of life interest of an assessee shall be determined as per Part F, Schedule III. Average net annual income of the assessee derived from the life interest during 3 years ending on the valuation date is calculated. While computing net annual income, expenses incurred on the collection of such income (maximum of 5% of the average of annual gross income) shall be deducted. This is multiplied as per formula prescribed to arrive at value of asset.

Valuation of jewellery **-** The value of jewellery shall be estimated to be the price which it would fetch if sold in the open market on the valuation date (*i.e.,* fair market value). Where the value of jewellery does not exceed Rs. 5,00,000, a statement in Form No. O-8A is to be submitted. Where the value of the jewellery exceeds Rs. 5,00,000, a report of a registered valuer in Form No. O-8 should be submitted. The report is not binding on assessing officer (Valuation Officer) and he can determine fair market value of jewellery.

The value of jewellery determined by the Valuation Officer for any assessment year shall be taken to be the value of such jewellery for the subsequent four assessment years subject to the prescribed adjustments.

Valuation of any other asset **-** The value of any asset, other than cash (being an asset which is not covered in above paras) shall be estimated either by the Assessing Officer himself or by the Valuation Officer if reference is made to him under section 16A. In both these cases, the value shall be estimated to be the price which it would fetch if sold in the open market, on the valuation date. If the asset is not saleable in the open market, the value shall be determined in accordance with guidelines or principles specified by the Board from time to time by general or special order.

3 Other issues relating to wealth tax

Charitable or religious trusts **-** A trust can forfeit exemption for any of the following reasons - (a*)* any part of the trust's property or any income of the trust, including income by way of voluntary contributions, is used for the benefit of the settlor, the trustee, their relatives etc.; or (b) any part of the income of the trust, created on or after April 1, 1962, including income by way of voluntary contributions, enures directly or indirectly, for the benefit of any of the persons referred to in section 13(3) of the Income-tax Act ; or (c) any funds of the trust are invested or deposited or any shares in a company are held by the trust in contravention of the investment pattern for trust funds laid down in section 11(5) of the Income-tax Act.

In such case, tax shall be leviable upon and recoverable from the trustee or manager in respect of the property held by him under trust at the rate of tax applicable to a resident in India.

These provisions are not applicable in the case of a scientific research association [Section 10(*21*) of the Income-tax Act] and in the case of any institution, fund or trust referred to in section 10(*22*), (*22A*), (*22B*) or (*23C*) of the Income-tax Act in specified situations [Section 21A]

Association of persons where shares of members are indeterminate/unknown **-** If assets chargeable to wealth-tax are held by an association of persons and the individual shares of the members in the income or assets of the association are indeterminate or unknown, wealth-tax is levied to the same extent as it would be leviable upon and recoverable from an individual who is citizen of India and resident in India [Section 21AA]

3-1 Return of wealth and assessment

Every person is required to file with the Wealth-tax Officer a return of net wealth in Form BA, if his net wealth or net wealth of any other person in respect of which he is assessable under the Act on the valuation date is of such an amount as to render him liable to wealth-tax. Return can be filed on or before the "due date" specified under section 139 of the Income-tax Act.

***Return in response to a notice* -** In the case of any person who, in the opinion of Wealth-tax Officer, is assessable to tax, the Wealth-tax Officer may, before the end of the relevant assessment year, issue a notice requiring him to furnish, within 30 days from the date of service of such notice, a return of net wealth in the prescribed form.

***Assessment* -** The assessee is required to pay the tax before filing of the return and such return is to be accompanied by the proof of such payment. Provisions of regular assessment, as applicable under Income Tax, will apply to wealth tax also.

***Interest or penalty and prosecution* -** Interest @ 1% per month is payable for failure to pay wealth tax on due date. Penalty and prosecution provisions also apply.

Mr. A has the following assets on 31-3-2008:

Asset	Market value on 31-3-2008 Rs. lakhs	Loan outstanding On 31-3-2008 Rs. Lakhs (loans taken acquire the asset)	Security Given for Taking the Loan
Gold and silver	80	6	Shares
Shares	10	3	House B
Residential House A	50	4	Gold
Residential House B	42	38	Personal
Commercial House C(used for Carrying on own business)	95	5	Personal
Boat	8	12	Gold
Motor cars	11	1	Silver
Bank deposit	1	1	------
Residential House D(let out throughout The financial year 2007-08)	55	40	House D
Commercial complex (having 20 offices)	190	100	Commercial Complex

A also took a bank loan of Rs. 75,000 against the security of his car for his friend's marriage. Out of the Rs. 12 lakh loan taken by him for purchasing the boat, he utilized Rs. 1 Lakh for his foreign visit. Compute the net wealth for assessment year 2008-09

Answer

	Assets (Rs. Lakh)	**Debts owed Rs. Lakhs**
Gold and silver	**80**	**6**
Shares- not an "asset" within the meaning of section 2*(ea)*	**----**	**----**
Residential House A[exempt under Section 5*(vi)*]	**---**	**----**
Residential House B	**42**	**38**
Commercial House C(used for Carrying on own business-Therefore it is not an "asset" within the meaning of section 2*(ea)*)	**----**	**----**
Boat	**8**	**11**
Motor cars	**11**	**1**
Bank deposit[not an asset within the meaning of section 2*(ea)*]	**----**	**---**
Residential House D(let out throughout the financial year 2005-06) – Residential house not an "asset" if let out for 300 days or more in the previous year.	**----**	**---**
Commercial complex (having 20 offices) not an "asset" within the meaning of section 2*(ea)*	**----**	**----**
Total	**141**	**56**

Net wealth = Rs 141 lakhs *minus* Rs 56 Lakhs = Rs. 85 lakhs

Mr. A owns a commercial house property which is situated at Pune. The difference between unbuilt area and specified area is 22% of the aggregate area. The property was acquired on 31-5-1988 for Rs. 12,50,000. The property is built on freehold land. How will the property be valued for wealth-tax purposes?

As the difference between unbuilt area and specified area exceeds 20% of the aggregate area, value shall be estimated by the Assessing Officer himself or by the Valuation Officer under section 16A if the reference is made to him under section 16A. In either case, the value shall be estimated to be the price which it would fetch if sold in the open market, on the valuation date. If the property is not saleable in the open market, valuation shall be as per CBDT's guidelines specified from time to time.