

UNIT 1 : INCOME FROM SALARIES

Question 1

- (i) Mr. Khanna, an employee of IOL, New Delhi, a private sector company, received the following for the financial year 2010-11:

	Rs.
1. Basic pay	1,20,000
2. House rent allowance	90,000
3. Special allowance	30,000

Mr. Khanna was residing at New Delhi and was paying a rent of Rs.10,000 a month.

Compute the eligible exemption under section 10(13A) of the Income-tax Act, 1961, in respect of house rent allowance received.

- (ii) If Mr. Khanna opts for rent free accommodation whereby IOL would be paying a rent of Rs.10,000 per month to the landlord and recovers a sum of Rs.2,500 per month from Mr. Khanna which was in excess of his entitlement, what will be the perquisite value in respect of such rent free accommodation?
- (iii) Which of the above would be beneficial to Mr. Khanna i.e., house rent allowance or rent free accommodation?

Answer

- (i) The eligible exemption under section 10(13A) in respect of house rent allowance received would be least of the following:

	Rs.	Rs.
(a) Actual house rent allowance (HRA) received		90,000
(b) Excess of rent paid over 10% of basic salary		
Rent paid (10,000 x 12)	1,20,000	
Less: 10% of basic pay (i.e. 10% of Rs.1,20,000)	<u>12,000</u>	1,08,000
(c) 50% of salary (i.e. 50% of Rs.1,20,000)		60,000
Least of the above is Rs.60,000.		

Taxation

The house rent allowance received by Mr. Khanna would be exempt to the extent of Rs.60,000 under section 10(13A). The balance of Rs.30,000 is includible in his total income.

(ii) Perquisite value in respect of concessional accommodation

As per rule 3(1), where the accommodation is taken on lease or rent by the employer, the actual amount of lease rental paid or payable by the employer or 15% of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee is the value of the perquisite.

(a) Actual rent paid by the employer = $10,000 \times 12 = 1,20,000$

(b) 15% of salary = 15% of basic pay plus special allowance =
15% of Rs.1,50,000 = Rs.22,500

Lower of the above is Rs.22,500, which should be reduced by the rent of Rs.30,000 paid by the employee (i.e. $2,500 \times 12 = 30,000$). The perquisite value is, therefore, nil.

(iii) We have to see the cash flow from both the options to find out which is more beneficial.

Option 1: HRA

	Rs.	Rs.
Cash inflows [Basic Pay + HRA + Special Allowance]		2,40,000
Less: Cash outflows:		
Rent paid	1,20,000	
Tax (See Working Note 1 below)	<u>2,060</u>	<u>1,22,060</u>
Net cash flow		<u>1,17,940</u>

Option 2: Concessional accommodation

Cash inflows [Basic Pay + Special Allowance]		1,50,000
Less: Cash outflows:		
Rent recovery	30,000	
Tax (See Working Note 2 below)	<u>Nil</u>	<u>30,000</u>
Net cash flow		<u>1,20,000</u>

Since the net cash flow is higher in Option 2, Mr. Khanna should opt for concessional accommodation, which would be more beneficial to him.

Working Notes :

1. Computation of tax under Option 1 (HRA):	Rs.
Salary:	
Basic Pay	1,20,000
HRA (taxable)	30,000
Special allowance	30,000
Total salary	<u>1,80,000</u>
Tax on Rs.1,80,000 (including cess)	2,060
2. Computation of tax under Option 2 (Concessional accommodation)	
Salary:	
Basic Pay	1,20,000
Special allowance	30,000
Concessional accommodation	Nil
Total salary	<u>1,50,000</u>
Tax on Rs.1,50,000	Nil

Question 2

Explain the term "Profit in lieu of salary".

Answer

Refer Para 1.5 in page 4.4 of Study Material.

Question 3

Write short note on valuation of paid holidays for perquisite purposes under section 17(2).

Answer

Refer sub rule 7(ii) of Rule 3 in page 4.35 of Study Material.

Question 4

Shri Hari is the General Manager of ABC Ltd. From the following details, compute the taxable income for the Assessment year 2011-12 :

<i>Basic salary</i>	<i>Rs.20,000 per month</i>
<i>Dearness allowance</i>	<i>30% of basic salary</i>
<i>Transport allowance</i>	<i>Rs.2,000 per month</i>

Taxation

Motor car running and maintenance charges fully paid by employer	Rs.36,000
<i>(The motor car is owned and driven by employee Hari. The engine cubic capacity is below 1.60 litres. The motor car is used for both official and personal purpose by the employee)</i>	
Expenditure on accommodation in hotels while touring on official duties met by the employer.	Rs.30,000
Loan from recognised provident fund (maintained by the employer)	Rs.40,000
Value of lunch provided by the employer during office hours.	
Cost to the employer	Rs.12,000
Computer (cost Rs.50,000) kept by the employer in the residence of Hari from 1.10.10	
Hari made the following payments:	
Medical insurance premium : Paid in cash	Rs.2,000
Paid by cheque	Rs.3,200

Answer

Computation of taxable income of Shri Hari for the A.Y. 2011-12

Particulars	Rs.	Rs.
Basic salary (20,000 x 12)		2,40,000
Dearness allowance @ 30%		72,000
Transport allowance (2,000 x 12)	24,000	
Less : Exemption u/s.10(14) (read with Rule 2BB @ Rs.800 p.m.) (See Note below)	9,600	14,400
Motor car maintenance borne by employer [36,000-21,600 (i.e., 1,800 × 12)]		14,400
Expenditure on accommodation while on official duty not a perquisite and hence not chargeable to tax		Nil
Loan from recognized provident fund – not chargeable to tax		Nil
Value of lunch provided during working hours – not chargeable to tax		Nil

Income from Salaries

Computer provided in the residence of employee by the employer – not chargeable to tax [Rule 3(7)(vii)]

Nil

Gross Salary

3,40,800

Less :Deduction under chapter VI-A

Deduction u/s.80D in respect of medical insurance premium paid by cheque

3,200

Premium paid in cash not eligible for deduction

Nil

3,200

Taxable income

3,37,600

Note : It is assumed that the transport allowance is for the purpose of commuting between the place of residence and place of duty.

Question 5

Distinguish between foregoing of salary and surrender of salary.

Answer

Foregoing of salary – Waiver by an employee of his salary is foregoing of salary. Once salary accrues, subsequent waiver does not absolve him from liability to income-tax.

Surrender of salary – If any employee surrenders his salary to the Central Government under the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the surrendered salary would not be included in computing his taxable income, whether he is a private sector/public sector or Government employee.

Question 6

Mr. X and Mr. Y are working for M/s. Gama Ltd. As per salary fixation norms, the following perquisites were offered:

- (i) *For Mr. X, who engaged a domestic servant for Rs.500 per month, his employer reimbursed the entire salary paid to the domestic servant i.e. Rs.500 per month.*
- (ii) *For Mr. Y, he was provided with a domestic servant @ Rs.500 per month as part of remuneration package.*

You are required to comment on the taxability of the above in the hands of Mr. X and Mr. Y, who are not specified employees.

Answer

In the case of Mr. X, it becomes an obligation which the employee would have discharged even if the employer did not reimburse the same. Hence, the perquisite will be covered under

Taxation

section 17(2)(iv) and will be taxable in the hands of Mr. X. This is taxable in the case of all employees.

In the case of Mr. Y, it cannot be considered as an obligation which the employee would meet. The employee might choose not to have a domestic servant. This is taxable only in the case of specified employees covered by section 17(2)(iii). Hence, there is no perquisite element in the hands of Mr. Y.

Question 7

Mr. Vignesh, Finance Manager of KLM Ltd., Mumbai, furnishes the following particulars for the financial year 2010-11.

- (i) Salary Rs.46,000 per month
- (ii) Value of medical facility in a hospital maintained by the company Rs.7,000
- (iii) Rent free accommodation owned by the company
- (iv) Housing loan of Rs.6,00,000 at the interest rate of 6% p.a. (No repayment made during the year).
- (v) Gifts in kind made by the company on the occasion of wedding anniversary of Mr. Vignesh Rs.4,750.
- (vi) A wooden table and 4 chairs were provided to Mr. Vignesh at his residence (dining table). This was purchased on 1.5.07 for Rs.60,000 and sold to Mr. Vignesh on 1.8.2010 for Rs.30,000.
- (vii) Personal purchases through credit card provided by the company amounting to Rs.10,000 was paid by the company. No part of the amount was recovered from Mr. Vignesh.
- (viii) An ambassador car which was purchased by the company on 16.7.07 for Rs.2,50,000 was sold to the assessee on 14.7.10 for Rs.80,000.

Other income received by the assessee during the previous year 2010-11.

	Rs.
(a) Interest on Fixed Deposits with a company	5,000
(b) Income from specified mutual fund	3,000
(c) Interest on bank deposits of a minor married daughter	3,000
(ix) Contribution to LIC towards premium under section 80CCC	Rs. 10,000
(x) Deposit in PPF Account made during the year 2010-11	Rs. 70,000

(xi) Bonds of ICICI (Tax savings) eligible for deduction under section 80C Rs. 30,000
 Compute the taxable income of Mr. Vignesh and the tax thereon for the Assessment year 2011-12.

Answer

Computation of taxable income of Mr. Vignesh for the Assessment Year 2011-12

	Rs.
Income under the head “salaries”	
Salary [Rs.46,000 x 12]	5,52,000
Medical facility [in the hospital maintained by the company exempt]	—
Rent free accommodation	
[Rule 3(1)] – 15% of salary is taxable	82,800
Use of dining table for 4 months	
[Rs. 60,000 x 10 /100 x 4 /12]	2,000
Valuation of perquisite of interest on loan	
[Rule 3(7)(i)] – 10% is taxable which is to be reduced by actual rate of interest charged i.e. [10% - 6% = 4%] [See Note below]	24,000
Gift given on the occasion of wedding anniversary Rs.4,750 is exempt, since its value is less than Rs. 5,000	-
Perquisite on sale of dining tables	
Cost	60,000
Less: Depreciation on straight line method @ 10% for 3 years	18,000
W.D.V	42,000
Less: Amount paid by the assessee	30,000
	12,000
Purchase through credit card – not being a privilege but covered by section 17(2)(iv)	10,000
Original cost of car	2,50,000
Less: Depreciation from 16.7.2007 to 15.7.2008 @ 20%	50,000
	2,00,000
Less: Depreciation from 16.7.2009 to 15.7.2010 @ 20% on WDV	40,000
Value as on 14.07.2010- being the date of sale to employee	1,60,000
Less : Amount received from the assessee on 14.07.2010	80,000
	80,000
Gross salary	7,62,800

Taxation

Computation of taxable income

(a)	Income from salaries		7,62,800
(b)	Income from other sources		
(i)	Interest on fixed deposit with a company	5,000	
(ii)	Income from specified mutual fund exempt under section 10(35)	Nil	
(iii)	Interest received by minor daughter (3,000 -1500)	<u>1,500</u>	6,500
	Gross total income		7,69,300
	Less: Chapter VI-A deductions		
	Section 80C – PPF & ICICI bonds	1,00,000	
	Section 80CCC – LIC	<u>10,000</u>	
	Overall deduction limited to Rs.1 lakh as per section 80 CCE		1,00,000
	Total Income		6,69,300
	Tax on income		67,860
	Add : Education cess @ 2%		1,357
	Add : Secondary and Higher Education cess @ 1%		679
	Total tax liability		69,896
	Total tax liability (rounded off)		69,900

Note :

- (i) It is presumed that the housing loan was availed on 1.4.2010. The rate of interest charged by State Bank of India (SBI) as on 01.04.2010 in respect of housing loan is assumed at 10% for determining the perquisite value for A.Y. 2011-12.
- (ii) Under Rule 3(7)(viii), while calculating the perquisite value of benefit to the employee arising from the transfer of any movable asset, the normal wear and tear is to be calculated in respect of each completed year during which the asset was put to use by the employer. In the given case the third year of use of ambassador car is completed on 15.7.2010 where as the car was sold to the employee on 14.7.2010. The solution worked out above provides for wear and tear for only two years.

Question 8

Mrs. Lakshmi aged about 66 years is a Finance Manager of M/s. Lakshmi & Co., Pvt. Ltd., based at Calcutta. She is in continuous service since 1965 and receives the following salary and perks from the company during the year ending 31.03.2011.

- (i) Basic Salary ($50,000 \times 12$) = Rs.6,00,000
- (ii) D.A. ($20,000 \times 12$) = Rs.2,40,000 (forms part of pay for retirement benefits)
- (iii) Bonus – 2 months basic pay.
- (iv) Commission – 0.1% of the turnover of the company. The turnover for the F.Y. 2010-11 was Rs.15.00 crores.
- (v) Contribution of the employer and employee to the PF Account Rs.3,00,000 each.
- (vi) Interest credited to P.F. Account at 8.5% - Rs.60,000.
- (vii) Rent free unfurnished accommodation provided by the company for which the company pays a rent of Rs.70,000 per annum.
- (viii) Entertainment Allowance – Rs.30,000.
- (ix) Hostel allowance for three children – Rs.5,000 each.

She makes the following payments and investments :

- (i) Premium paid to insure the life of her major son – Rs.15,000.
- (ii) Medical Insurance premium for self – Rs.6,000 ; Spouse – Rs.6,000.
- (iii) Donation to a public charitable institution registered under 80G Rs.2,00,000.
- (iv) LIC Pension Fund – Rs.12,000.

Determine the tax liability for the Assessment Year 2011-12.

Answer**Computation of Total Income of Mrs. Lakshmi for A.Y. 2011-12**

	Rs.
Income from salary	
Basic salary	6,00,000
Dearness allowance	2,40,000
Bonus	1,00,000

Taxation

Commission (calculated as percentage of turnover)	1,50,000
Entertainment allowance	30,000
Children's hostel allowance	15,000
Less : Exemption (300 x 12 x 2)	<u>7,200</u>
	7,800
Interest credited to PF account (exempt)	-
Rent free unfurnished accommodation (Refer working Note 1)	70,000
Excess contribution to PF by employer (Refer working Note 2)	<u>1,81,200</u>
Gross salary	13,79,000
Less : Deduction u/s.80C	
LIC	15,000
PF	3,00,000
Deduction u/s.80CCC in respect of LIC pension fund limited to	<u>10,000</u>
	3,25,000
Deduction limited to Rs.1,00,000 as per section 80CCE	1,00,000
Deduction u/s 80D	<u>12,000</u>
Total income before deduction u/s.80G	12,67,000
Deduction u/s.80G :	
50% of Rs.1,26,700 (10% total income)	<u>63,350</u>
Total income	12,03,650
Tax on total income	2,07,095
Add : Education cess @ 2%	4,142
Add : Secondary and higher education cess @ 1%	<u>2,071</u>
Total tax liability	2,13,308
Rounded off	2,13,310

Working Notes:

1. Value of rent free unfurnished accommodation

Basic salary	6,00,000
Dearness allowance	2,40,000

Income from Salaries

Bonus	1,00,000
Commission @ 1% of turnover	1,50,000
Entertainment allowance	30,000
Children's hostel allowance	7,800
Gross Salary	<u>11,27,800</u>

15% of salary	1,69,170
Actual rent paid by the company	70,000
The least of the above is chargeable perquisite.	

2. Employer's contribution to P.F. in excess of 12% of salary

Employer's contribution	3,00,000
Less : 12% of basic salary, dearness allowance & commission	
12% of Rs.9,90,000	1,18,800
	<u>1,81,200</u>

Question 9

Following benefits have been granted by Ved Software Ltd. to one of its employees Mr. Badri:

- (i) *Housing loan @ 6% per annum. Amount outstanding on 1.4.2010 is Rs. 6,00,000. Mr. Badri pays Rs. 12,000 per month, on 5th of each month.*
- (ii) *Air-conditioners purchased 4 years back for Rs. 2,00,000 have been given to Mr. Badri for Rs. 90,000.*

Compute the chargeable perquisite in the hands of Mr. Badri for the A.Y. 2011-12.

The lending rate of State Bank of India as on 1.4.2010 for housing loan may be taken as 10%.

Answer

Perquisite value for housing loan

The value of the benefit to the assessee resulting from the provision of interest-free or concessional loan made available to the employee or any member of his household during the relevant previous year by the employer or any person on his behalf shall be determined as the sum equal to the interest computed at the rate charged per annum by the State Bank of India (SBI) as on the 1st day of the relevant previous year in respect of loans for the same purpose

Taxation

advanced by it. This rate should be applied on the maximum outstanding monthly balance and the resulting amount should be reduced by the interest, if any, actually paid by him.

“Maximum outstanding monthly balance” means the aggregate outstanding balance for loan as on the last day of each month.

The perquisite value for computation is $10\% - 6\% = 4\%$

Month	Maximum outstanding balance as on last date of month	Perquisite value at 4% for the month
April, 2010	5,88,000	1,960
May, 2010	5,76,000	1,920
June, 2010	5,64,000	1,880
July, 2010	5,52,000	1,840
August, 2010	5,40,000	1,800
September, 2010	5,28,000	1,760
October, 2010	5,16,000	1,720
November, 2010	5,04,000	1,680
December, 2010	4,92,000	1,640
January, 2011	4,80,000	1,600
February, 2011	4,68,000	1,560
March, 2011	4,56,000	<u>1,520</u>
Total value of this perquisite		<u>20,880</u>

Perquisite Value of Air Conditioners

	Rs.
Original cost	2,00,000
Depreciation on SLM basis for 4 years @10% i.e. Rs.2,00,000 x10% x 4	<u>80,000</u>
Written down value	1,20,000
Amount recovered from the employee	<u>90,000</u>
Perquisite value	<u>30,000</u>

Chargeable perquisite in the hands of Mr. Badri for the assessment year 2011-12

	Rs.
Housing loan	20,880
Air Conditioner	<u>30,000</u>
Total	<u>50,880</u>

Question 10

Mr. Narendra, who retired from the services of Hotel Samode Ltd., on 31.1.2011 after putting on service for 5 years, received the following amounts from the employer for the year ending on 31.3.2011:

- ◆ Salary @ Rs. 16,000 p.m. comprising of basic salary of Rs. 10,000, Dearness allowance of Rs. 3,000, City compensatory allowance of Rs. 2,000 and Night duty allowance of Rs. 1,000.
- ◆ Pension @ 30% of basic salary from 1.2.2011.
- ◆ Leave salary of Rs. 75,000 for 225 days of leave accumulated during 5 years @ 45 days leave in each year. He has not availed any earned leave during his tenure of 5 years and utilized only his casual leave.
- ◆ Gratuity of Rs. 50,000.

Compute the total income of Mr. Narendra for the assessment year 2011-12.

Answer

Computation of total income of Mr. Narendra for A.Y. 2011-12

Particulars	Amount (Rs.)	Amount (Rs.)
Income from Salaries		
Gross salary received during 1.4.10 to 31.1.11 @ Rs. 16,000 p.m. (Rs. 16,000 x 10)		1,60,000
Pension for 2 months @ 30% of the basic salary of Rs.10,000 p.m.		6,000
Leave Salary	75,000	
Less: Exempt under section 10(10AA) (Note1)	50,000	25,000
Gratuity	50,000	
Less: Exempt under section 10(10) (Note2)	25,000	25,000
Total Income		2,16,000

Notes:

1. Leave encashment is exempt to the extent of least of the following :

	Particulars	Amount (Rs.)
(i)	Statutory limit	3,00,000
(ii)	Cash equivalent of leave for 30 days (30/45 x Rs.75,000)	50,000

Taxation

(iii)	10 months average salary (10 x Rs.10,000)	1,00,000
(iv)	Actual amount received	75,000

Therefore, Rs.50,000 is exempt under section 10(10AA).

2. Gratuity is exempt to the extent of least of the following :

	Particulars	Amount (Rs.)
(i)	Statutory limit	10,00,000
(ii)	Half month's salary for 5 years of service (5 x Rs.5,000)	25,000
(iii)	Actual gratuity received	50,000

Therefore, Rs.25,000 is exempt under section 10(10). It is assumed that the employee is not covered under The Payment of Gratuity Act, 1972.

Question 11

How is advance salary taxed in the hands of an employee? Is the tax treatment same for loan or advance against salary?

Answer

Advance Salary

Advance salary is taxable when it is received by the employee, irrespective of the fact whether it is due or not.

It may so happen that when advance salary is included and charged in a particular previous year, the rate of tax at which the employee is assessed may be higher than the normal rate of tax to which he would have been assessed. Section 89(1) provides for relief in these types of cases.

Loan or Advance against salary

Loan is different from salary. When an employee takes a loan from his employer, which is repayable in certain specified installments, the loan amount cannot be brought to tax as salary of the employee.

Similarly, advance against salary is different from advance salary. It is an advance taken by the employee from his employer. This advance is generally adjusted against his salary over a specified time period. It cannot be taxed as salary.

Question 12

Mr. M is an area manager of M/s N. Steels Co. Ltd. During the financial year 2010-11, he gets the following emoluments from his employer:

<i>Basic Salary</i>	
<i>Up to 31.8.2010</i>	<i>Rs. 20,000 p.m.</i>
<i>From 1.9.2010</i>	<i>Rs. 25,000 p.m.</i>
<i>Transport allowance</i>	<i>Rs. 2,000 p.m.</i>
<i>Contribution to recognised provident fund</i>	<i>15% of basic salary</i>
<i>Children education allowance</i>	<i>Rs. 500 p.m. for two children</i>
<i>City compensatory allowance</i>	<i>Rs. 300 p.m.</i>
<i>Hostel expenses allowance</i>	<i>Rs. 380 p.m. for two children</i>
<i>Tiffin allowance (actual expenses Rs. 3,700)</i>	<i>Rs. 5,000 p.a.</i>
<i>Tax paid on employment</i>	<i>Rs. 2,500</i>

Compute taxable salary of Mr. M for the Assessment year 2011-12.

Answer

Computation of taxable salary of Mr. M. for the Assessment Year 2011-12

Particulars	Amount (Rs.)	Amount (Rs.)
Basic Salary (Rs.20,000 x 5) +(Rs.25,000 x 7)		2,75,000
Transport allowance (Rs.2,000 x 12)	24,000	
Less : Exempt under section 10(14) (Rs.800 x 12)	9,600	14,400
Children education allowance (Rs.500 x 12)	6,000	
Less: Exempt under section 10(14) (Rs.100 x 2 x 12)	2,400	3,600
City Compensatory Allowance (Rs.300 x 12)		3,600
Hostel Expenses Allowance (Rs.380 x 12)	4,560	
Less: Exempt under section 10(14) (Rs.300 x 2 x 12 i.e. Rs.7,200 but restricted to the actual allowance of Rs.4,560)	4,560	Nil
Tiffin allowance (fully taxable)		5,000
Tax paid on employment [See Note Below]		2,500

Taxation

Employer's contribution to R.P.F in excess of 12% of salary (i.e 3% of Rs.2,75,000)	8,250
Gross Salary	3,12,350
Less : Tax on employment under section 16(iii)	2,500
Taxable salary	3,09,850

Note:

Professional tax paid by employer should be included in the salary of Mr. M as a perquisite since it is discharge of monetary obligation of the employee by the employer. Thereafter, deduction of professional tax paid is allowed to the employee from his gross salary.

Question 13

Mr. Ashok Kumar, an employee of a PSU, furnishes the following particulars for the previous year ending 31.3.2011:

	Rs.
i. Salary income for the year	5,25,000
ii. Salary for Financial Year 2006-07 received during the year	40,000
iii. Assessed Income for the Financial Year 2006-07	1,40,000

You are requested by the assessee to compute relief under section 89 of the Income-tax Act, 1961, in terms of tax payable for assessment year 2011-12.

The rates of Income-tax for the assessment year 2007-08 are:

	Tax Rate (%)
On first Rs. 1,00,000	Nil
On Rs. 1,00,000 – Rs. 1,50,000	10
On Rs. 1,50,000 – Rs. 2,50,000	20
Above Rs. 2,50,000	30
Education cess	2

Answer

Computation of Relief under section 89 for the Assessment Year 2011-12

Particulars	Rs.	Rs.
Salary Income for the year excluding the arrears		5,25,000
Add: Arrears relating to Financial Year 2006-07		40,000
Total Income		5,65,000

Income from Salaries

Assessment year 2011-12

Tax on Rs.5,65,000

First Rs.1,60,000	Nil	0
Next Rs.3,40,000	10%	34,000
Balance <u>65,000</u>	20%	13,000
<u>5,65,000</u>		<u>47,000</u>

Add: Education cess @ 2% 940

Secondary and higher education cess @1% 470

Tax on total income (including arrears) (A) 48,410

Total Income excluding arrears 5,25,000

Tax on Rs.5,25,000

First Rs.1,60,000	Nil	0
Next Rs.3,40,000	10%	34,000
Balance <u>25,000</u>	20%	5,000
<u>5,25,000</u>		<u>39,000</u>

Add : Education cess @ 2% 780

Secondary and higher education cess @ 1% 390

Tax on total income (excluding arrears) (B) 40,170

Difference between A & B I 8,240

Assessment Year 2007-08

Total Income assessed 1,40,000

Add: Arrears relating to Financial year 2006-07 40,000

Total income (including arrears) 1,80,000

Tax on Rs.1,80,000 11,000

Add: Education Cess @ 2% 220

Tax on total income (including arrears) (C) 11,220

Taxation

Total Income excluding arrears		1,40,000
Tax on Rs.1,40,000		4,000
Add: Education Cess @ 2%		80
Tax on total income (excluding arrears) (D)		4,080
Difference between C & D	II	7,140
Relief under section 89 (I – II)		1,100
Tax payable for A.Y. 2011-12 (Rs.48,410 – Rs.1,100)		47,310

UNIT 2 : INCOME FROM HOUSE PROPERTY

Question 1

Mrs. Rohini Ravi, a citizen of the U.S.A., is a resident and ordinarily resident in India during the financial year 2010-11. She owns a house property at Los Angeles, U.S.A., which is used as her residence. The annual value of the house is \$20,000. The value of one USD (\$) may be taken as Rs.45.

She took ownership and possession of a flat in Chennai on 1.7.2010, which is used for self-occupation, while she is in India. The flat was used by her for 7 months only during the year ended 31.3.2011. Whilst the municipal valuation is Rs.32,000 p.m., the fair rent is Rs.4,20,000 p.a. She paid the following to Corporation of Chennai :

Property Tax	Rs.16,200
Sewerage Tax	Rs.1,800

She had taken a loan from Standard Chartered Bank for purchasing this flat. Interest on loan was as under:

	Rs.
Period prior to 1.4.2010	49,200
1.4.2010 to 30.6.2010	50,800
1.7.2010 to 31.3.2011	1,31,300

She had a house property in Bangalore, which was sold in March, 2008. In respect of this house, she received arrears of rent of Rs.60,000 in March, 2011. This amount has not been charged to tax earlier.

Compute the income chargeable from house property of Mrs. Rohini Ravi for the assessment year 2011-12, exercising the most beneficial option available.

Answer

Since the assessee is a resident and ordinarily resident in India, her global income would form part of her total income i.e., income earned in India as well as outside India will form part of her total income.

She possesses a self-occupied house at Los Angeles as well as at Chennai. At her option, one house shall be treated as self-occupied, whose annual value will be nil. The other self-occupied house property will be treated as "deemed let out property".

The annual value of the Los Angeles house is Rs. 9,00,000 and the Chennai flat is Rs. 3,15,000. Since the annual value of Los Angeles house is obviously more, it will be

Taxation

beneficial for her to opt for choosing the same as self-occupied. The Chennai house will, therefore, be treated as "deemed let out property"

As regards the Bangalore house, arrears of rent will be chargeable to tax as income from house property in the year of receipt under section 25B. It is not essential that the assessee should continue to be the owner. 30% of the arrears of rent shall be allowed as deduction.

Accordingly, the income from house property of Mrs. Rohini Ravi will be calculated as under:

Particulars	Rs.	Rs.
1. Self-occupied house at Los Angeles.		
Annual value	Nil	
Less: Deduction u/s. 24	Nil	
Chargeable income from this house property	Nil	
2. Deemed let out house property at Chennai		
Annual value (Higher of municipal value and fair rent) [35,000 x 9]		3,15,000
Less: Municipal Taxes (Property tax + Sewerage tax)		18,000
Net Annual Value (NAV)		2,97,000
Less: Deductions u/s. 24		
30% of NAV	89,100	
Interest on borrowed capital (See Note below)	1,91,940	
		2,81,040
		15,960
3. Arrears in respect of Bangalore property		
Arrears of rent received	60,000	
Less: Deduction @ 30%	18,000	
		42,000
Income chargeable under the head "Income from house property"		57,960
Note : Interest on borrowed capital		Rs.
Interest for the current year (Rs.50,800 + Rs.1,31,300)		1,82,100
Add: 1/5th of pre-construction interest (Rs.49,200 x 1/5)		9,840
Interest deduction allowable under section 24		1,91,940

Question 2

What do you understand by “Composite Rent”? What is the tax treatment of Composite Rent under the Income-tax Act, 1961?

Answer

Refer para 2.3 in page 4.55 of Study Material.

Question 3

Ownership itself is the criteria for assessment under the head income from house property. Discuss.

Answer

Section 27 enumerates certain cases, where the legal ownership may vest with one person whereas the taxability is cast on another person who is deemed to be the owner.

In these specific cases, the charge of tax is on the deemed owner and not on the legal owner. The exceptions are given below :

- (i) In case of transfer of house property to spouse (not being a transfer in connection with an agreement to live apart) or minor child (not being a married daughter) without adequate consideration - transferor is the deemed owner.
- (ii) Holder of an impartible estate – shall be deemed to be the individual owner of all the properties comprised in the estate.
- (iii) A member of a co-operative society/company/AOP to whom a building or part thereof is allotted or leased under a house building scheme – shall be deemed to be the owner of building or part thereof.
- (iv) A person who is allowed to take or retain possession of any building or part thereof is the deemed owner of such building or part thereof if such possession is obtained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882.
- (v) Acquisition of rights in or with respect to any building or part thereof, whether by way of admitting as a member of or by way of transfer of shares in cooperative society or company or other association of persons etc. – person acquiring such rights shall be the deemed owner.

Therefore, legal ownership itself is not the criteria for assessment of income under the head “Income from house property”.

Also, the provisions of section 25AA and 25B dealing with receipt of unrealised rent and arrears of rent also fall in this category. The receipt is considered as income under the head ‘house property’ though the recipient may not have legal ownership of the property to which the receipt relates.

Taxation

Question 4

Mr. A and B constructed their houses on a piece of land purchased by them at New Delhi. The built up area of each house was 1,000 sq.ft. ground floor and an equal area in the first floor. A started construction on 1-04-09 and completed on 1-04-2010. B started the construction on 1-04-09 and completed the construction on 30-06-10. A occupied the entire house on 01-04-10. B occupied the ground floor on 01-07-10 and let out the first floor for a rent of Rs.15,000 per month. However, the tenant vacated the house on 31-12-10 and B occupied the entire house during the period 01-01-11 to 31-03-11.

Following are the other information

(i)	Fair rental value of each unit (ground floor /first floor)	Rs.1,00,000 per annum
(ii)	Municipal value of each unit (ground floor / first floor)	Rs.72,000 per annum
(iii)	Municipal taxes paid by	A – 8,000 B – 8,000
(iv)	Repair and maintenance charges paid by	A – 28,000 B – 30,000

A has availed a housing loan of Rs.20 lakhs @ 12% p.a. on 01-04-09. B has availed a housing loan of Rs.12 lakhs @ 10% p.a. on 01-07-09. No repayment was made by either of them till 31-03-11. Compute income from house property for A and B for the previous year 2010-11 (A.Y. 2011-12).

Answer

Computation of income from house property of Mr. A for A.Y. 2011-12

Particulars	Rs.	Rs.
Annual value is nil (since house is self occupied)		Nil
Less : Deduction u/s.24(b)		
Interest paid on borrowed capital Rs.20,00,000 @ 12%	2,40,000	
Pre-construction interest Rs.2,40,000 / 5	48,000	
	<u>2,88,000</u>	
As per second proviso to section 24(b), interest deduction restricted to		<u>1,50,000</u>
Loss under the head "income from house property" of Mr. A		<u>(1,50,000)</u>

Income from House Property

Computation of income from house property of Mr. B for A.Y. 2011-12

Particulars	Ground floor (Self occupied)	First floor
Gross annual value (See note below)	Nil	90,000
Less :Municipal taxes (for first floor)		4,000
Net annual value (A)	Nil	86,000
Less : Deduction u/s.24		
(a) 30% of net annual value		25,800
(b) interest on borrowed capital		
Current year interest		
12,00,000 x 10% = 1,20,000	60,000	60,000
Pre-construction interest		
12,00,000 x 10% x 9/12 = 90,000		
90,000 allowed in 5 equal instalments		
90000 / 5 = Rs.18,000 per annum	9,000	9,000
Total deduction u/s.24 (B)	69,000	94,800
Income from house property (A)-(B)	(69,000)	(8,800)
Loss under the head "income from house property" of Mr.B (both ground floor and first floor)	(77,800)	

Note : Computation of Gross Annual Value (GAV) of first floor of B's house – If a single unit of property (in this case the first floor of B's house) is let out for some months and self-occupied for the other months, then the annual letting value (ALV) of the property shall be taken into account for determining the annual value. The ALV shall be compared with the actual rent and whichever is higher shall be adopted as the annual value. In this case, the actual rent shall be the rent for the period for which the property was let out during the previous year.

The Annual Letting Value (ALV) is the higher of fair rent and municipal value. This should be considered for 9 months since the construction of property was completed only on 30.6.2010.

Annual letting value = Rs.75,000 being higher of -

Fair rent = 1,00,000 x 9 /12 = Rs.75,000

Municipal value = 72,000 x 9/12 = Rs.54,000

Actual rent = Rs.90,000 (Rs.15,000 p.m. for 6 months from July to December, 2010)

Gross annual value = Rs.90,000 (being higher of ALV of Rs.75,000 and actual rent of Rs.90,000)

Question 5

Discuss the following issues relating to Income from house property.

- (i) *Income earned by residents from house properties situated in foreign countries.*
- (ii) *Properties which are used for agricultural purposes.*

Answer

- (i) In case of resident individual, his global income is taxable in India. Therefore, income earned by residents from house properties situated in foreign countries is taxable in India.

If the income from house properties situated outside India is chargeable to tax in India the annual value of such property would be computed as if the property is situated in India. Further, municipal taxes paid under the laws of that country can also be deducted while arriving at the Annual Value of the property. The Madras High Court in *CIT v. Venugopala Reddiar [1965] 58 ITR 439* observed that while computing taxable income, no distinction should be made between a house property situated in India and a house property situated abroad.

- (ii) If the property is used for agricultural purposes, the annual value of such property would be treated as "Agricultural Income" as per section 2(1A)(c) and it is exempt under section 10(1) of the Act. However, if the house property is used for purpose other than agriculture the annual value of such property cannot be treated as agricultural income.

Question 6

Discuss the treatment of unrealised rent and its recovery in subsequent years.

Answer

As per Explanation to section 23(1), the amount of rent which the owner cannot realize shall not be taxed / included while determining the annual value of the property. Rule 4 prescribes the conditions, which are to be satisfied for excluding the unrealised rent from income which are given below:

- (a) the tenancy must be bonafide
- (b) the defaulting tenant has vacated or steps have been taken to compel him to vacate the property.
- (c) the defaulting tenant is not in the occupation any other property of the assessee and
- (d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of unpaid rent or satisfies the Assessing Officer that the legal proceedings would be useless.

As per section 25AA, the unrealised rent when realised is chargeable to tax as income under the head 'house property', whether or not the assessee is the owner of the property at the time of receipt of unrealised rent. No deduction is allowable against the sum received towards unrealised rent.

Question 7

In the following cases, state the head of income under which the receipt is to be assessed and comment.

- (1) *X let out his property to Y. Y sublets it. How is sub-letting receipt to be assessed in the hands of Y.*
- (2) *Y has built a house on a leasehold land. He has let out the property and claims income from house property under "Other sources" and deducted expenses on repairs, security charges, insurance and collection charges in all amounting to 40% of receipts.*
- (3) *Z uses his property for his own business. Can he claim depreciation?*

Answer

- (1) Sub-letting receipt in the hands of Y can be assessed as "Income from Other Sources" or as "Profits and gains from business or profession" depending upon the facts and circumstances of each case. It is not assessable as income from house property.
- (2) It is assessable as "Income from house property" since ownership of land is not a pre-requisite for assessment of income under this head. 30% of Net Annual Value is allowed as deduction under section 24.
- (3) Where the assessee uses his property for business, it is not assessable as property income. He is entitled to depreciation under section 32(1)(ii) on the building.

Question 8

Discuss the tax liability in respect of arrears of rent.

Answer

As per section 25B, where the assessee receives any amount by way of arrears of rent in respect of any property consisting of buildings or land appurtenant thereto of which he is the owner, the amount so received shall be chargeable to tax under the head "Income from House Property". It shall be charged to tax as the income of the previous year in which such rent is received even if the assessee is no longer the owner of such property. In computing the income chargeable to tax in respect of the arrears so received, 30% shall be allowed as a deduction and consequently 70% alone shall be chargeable to tax. The deduction of 30% is irrespective of the actual expenditure incurred.

Question 9

Mr. Kalpesh borrowed a sum of Rs. 30 lakhs from the National Housing Bank towards purchase of a residential flat. The loan amount was disbursed directly to the flat promoter by the bank. Though the construction was completed in May, 2011, repayments towards principal and interest had been made during the year ended 31.3.2011.

In the light of the above facts, state:

- (i) *Whether Mr. Kalpesh can claim deduction under Section 24 in respect of interest for the assessment year 2011-12;*
- (ii) *Whether deduction under Section 80C can be claimed for the above assessment year, even though the construction was completed only after the closure of the year?*

Answer

(a) Interest on borrowed capital is allowed as deduction under section 24(b)

Interest payable on loans borrowed for the purpose of acquisition, construction, repairs, renewal or reconstruction of house property can be claimed as deduction under section 24(b). Interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed, can be claimed as deduction over a period of 5 years in equal annual installments commencing from the year of acquisition or completion of construction.

It is stated that the construction is completed only in May, 2011. Hence, deduction in respect of interest on housing loan cannot be claimed in the assessment year 2011-12.

- (b)** Clause (xviii) of section 80C is attracted where there is any payment for the purpose of purchase or construction of a residential house property, the income from which is chargeable to tax under the head 'Income from house property'. Such payment covers repayment of any amount borrowed from the National Housing Bank.

However, deduction is prima facie eligible only if the income from such property is chargeable to tax under the head "Income from House Property". During the assessment year 2011-12, there is no such income chargeable under this head. Hence, deduction under section 80C cannot be claimed for A.Y. 2011-12.

Question 10

Mr. X owns one residential house in Mumbai. The house is having two units. First unit of the house is self occupied by Mr. X and another unit is rented for Rs.8,000 p.m. The rented unit was vacant for 2 months during the year. The particulars of the house for the previous year 2010-11 are as under:

Income from House Property

Standard rent	Rs. 1,62,000 p.a.
Municipal valuation	Rs. 1,90,000 p.a.
Fair rent	Rs. 1,85,000 p. a
Municipal tax	15% of municipal valuation
Light and water charges	Rs. 500 p.m.
Interest on borrowed capital	Rs. 1,500 p.m.
Lease money	Rs. 1,200 p.a.
Insurance charges	Rs. 3,000 p.a.
Repairs	Rs. 12,000 p.a.
Compute income from house property of Mr. X for the A.Y. 2011-12.	

Answer

Computation of Income from house property for A.Y. 2011-12

(A) Rented unit (50% of total area – See Note 1 below)

Step I - Computation of Annual letting Value	Rs.	Rs.
Municipal valuation (Rs.1,90,000 x ½)	95,000	
Fair rent (Rs.1,85,000 x ½)	92,500	
Standard rent (Rs.1,62,000 x ½)	81,000	
Annual letting value is higher of municipal valuation and fair rent, but restricted to standard rent	81,000	
Step II - Actual Rent		
Rent receivable for the whole year (Rs.8,000 x 12)	96,000	
Step III – Computation of Gross Annual Value		
Actual rent received owing to vacancy (Rs.96,000 – Rs.16,000)	80,000	
Since, owing to vacancy the actual rent received is lower than the annual letting value, the actual rent received is the Gross Annual value		
Gross annual value		80,000
Less: Municipal taxes (15% of Rs.95,000)		14,250
Net Annual value		65,750
Less : Deductions under section 24		
(i) 30% of net annual value	19,725	

Taxation

(ii) Interest on borrowed capital (Rs.750 x 12)–	9,000	28,725
Taxable income from let out portion		37,025
(B) Self occupied unit (50% of total area – See Note 1 below)		
Annual value	Nil	
Less : Deduction under section 24		
Interest on borrowed capital (Rs.750 x 12)–	9,000	9,000
Income from house property		28,025

Notes:

- (1) It is assumed that both the units are of identical size. Therefore, the rented unit would represent 50% of total area and the self-occupied unit would represent 50% of total area.
- (2) It is assumed that the municipal taxes have been paid by the owner during the year.
- (3) No deduction will be allowed separately for light and water charges, lease money paid, insurance charges and repairs.

Question 11

Mrs. Indu, a resident individual, owns a house in U.S.A. She receives rent @ \$ 2,000 per month. She paid municipal taxes of \$ 1,500 during the financial year 2010-11. She also owns a two storied house in Mumbai, ground floor is used for her residence and first floor is let out at a monthly rent of Rs.10,000. Standard rent for each floor is Rs.11,000 per month and fair rent is Rs. 10,000 per month. Municipal taxes paid for the house amounts to Rs.7,500. Mrs. Indu had constructed the house by taking a loan from a nationalised bank on 20.6.2006. She repaid the loan of Rs.54,000 including interest of Rs.24,000. The value of one dollar is to be taken as Rs.45.

Compute total income from house property of Mrs. Indu.

Answer

Computation of Income from House Property of Mrs. Indu for the Assessment Year 2011-12

Particulars	Rs.	Rs.
House property in USA		
GAV– Rent received {treated as fair rent} (\$2000 p.m. x Rs.45 per USD x 12 months)	10,80,000	
Less : Municipal taxes paid (\$1500 x Rs.45 per USD)	67,500	
Net Annual Value (NAV)	10,12,500	
Less : Deduction under section 24		
30% of NAV	3,03,750	7,08,750

Income from House Property

House property in Mumbai (Let- out portion - First Floor)

Annual Letting Value (lower of standard rent and fair rent)

Standard Rent (Rs.11,000 x 12)	1,32,000	
Fair rent (Rs.10,000 x 12)	1,20,000	1,20,000

Actual rent received (10,000 × 12) 1,20,000

Gross Annual Value (higher of ALV and actual rent) 1,20,000

Less : Municipal taxes paid (50% of Rs.7,500) 3,750

Net Annual Value (NAV) 1,16,250

Less : Deduction under section 24

30% of NAV	34,875		
Interest on housing loan (50% of Rs.24,000)	12,000	46,875	69,375

Income from House property in Mumbai (Self-occupied portion - Ground Floor)

Gross annual value Nil

Less: Municipal taxes Nil

Net Annual Value (NAV) Nil

Less : Deduction under section 24

30% of NAV	Nil		
Interest on housing loan (50% of Rs.24,000)	12,000	(-) 12,000	

Income from house property 7,66,125

Question 12

Choose the correct answer with reference to the provisions of Income-tax Act, 1961:

The ceiling limit of deduction under section 24(b) in respect of interest on loan taken on 1.4.2007 for repairs of a self-occupied house is:

- (a) Rs. 30,000 per annum
- (b) Rs. 1,50,000 per annum
- (c) No limit
- (d) 30% of NAV

Answer

- (a) Rs.30,000 per annum

Question 13

Fill in the blanks by choosing the correct answer from the bracket.

- (i) *If the assessee lets out his house to his employer company, which in return, allots the same to him as rent free accommodation, the assessee(is / is not) entitled to the benefit of section 23(2)(a) regarding annual value to be taken as nil being self-occupied house property.*
- (ii) *An assessee, after sale of house property, receiving arrears of rent, (is/is not) chargeable to tax; the same computed in the stipulated manner, shall be chargeable to tax as..... (income from other sources/income from house property/question does not arise since there is no chargeability to tax).*

Answer

- (i) is not.
- (ii) is, income from house property.

Question 14

State whether True/False with proper reasons of the following statement:

Arrears of rent received shall be charged to income-tax as income of the previous year in which rent was received irrespective of whether the assessee is the owner of property in that year or not.

Answer

True

As per section 25B, the arrears of rent will be charged to tax in the year in which it was received, whether or not the assessee is the owner of the property at that time.

UNIT 3 : PROFITS AND GAINS OF BUSINESS OR PROFESSION

Question 1

Miss Vivitha, a resident and ordinarily resident in India, has derived the following income from various operations (relating to plantations and estates owned by her) during the year ended 31-3-2011:

	Rs.
(i) Income from sale of centrifuged latex processed from rubber plants grown in Darjeeling.	3,00,000
(ii) Income from sale of coffee grown and cured in Yercaud, Tamil Nadu.	1,00,000
(iii) Income from sale of coffee grown, cured, roasted and grounded, in Colombo. Sale consideration was received at Chennai.	2,50,000
(iv) Income from sale of tea grown and manufactured in Shimla.	4,00,000
(v) Income from sapling and seedling grown in a nursery at Cochin. Basic operations were not carried out by her on land.	80,000

You are required to compute the business income and agricultural income of Miss Vivitha for the assessment year 2011-12.

Answer

Computation of business income and agricultural income of Ms.Vivitha for the A.Y.2011-12

Sl. No.	Source of income	Gross (Rs.)	Business income %	Amount (Rs.)	Agricultural income Amount (Rs.)
(i)	Sale of centrifuged latex from rubber plants grown in India.	3,00,000	35%	1,05,000	1,95,000
(ii)	Sale of coffee grown and cured in India.	1,00,000	25%	25,000	75,000
(iii)	Sale of coffee grown, cured, roasted and grounded outside India. (See Note 1 below)	2,50,000	100%	2,50,000	-

Taxation

(iv)	Sale of tea grown and manufactured in India	4,00,000	40%	1,60,000	2,40,000
(v)	Saplings and seedlings grown in nursery in India (See Note 2 below)	80,000		-	80,000
Total				5,40,000	5,90,000

Note:

1. Where income is derived from sale of coffee grown, cured, roasted and grounded by the seller in India, 40% of such income is taken as business income and the balance as agricultural income. However, in this question, these operations are done in Colombo, Sri Lanka. Hence, there is no question of such apportionment and the whole income is taxable as business income. Receipt of sale proceeds in India does not make this agricultural income. In the case of an assessee, being a resident and ordinarily resident, the income arising outside India is also chargeable to tax.
2. Explanation 3 to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income whether or not the basic operations were carried out on land.

Question 2

Vinod is a person carrying on profession as film artist. His gross receipts from profession are as under:

	Rs.
<i>Financial year 2008-09</i>	<i>1,15,000</i>
<i>Financial year 2009-10</i>	<i>1,80,000</i>
<i>Financial year 2010-11</i>	<i>2,10,000</i>

What is his obligation regarding maintenance of books of accounts for each Assessment Year under section 44AA of Income-tax Act, 1961?

Answer

Section 44AA(1) requires every person carrying on any profession, notified by the Board in the Official Gazette (in addition to the professions already specified therein), to maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act, 1961.

Thus, a person carrying on a notified profession shall be required to maintain specified books of accounts :

- (i) if his gross receipts in all the three years immediately preceding the relevant previous year has exceeded Rs.1,50,000; or

- (ii) if it is a new profession which is setup in the relevant previous year, it is likely to exceed Rs.1,50,000 in that previous year.

In the present case, Vinod is a person carrying on profession as film artist, which is a notified profession. Since his gross receipts have not exceeded Rs.1,50,000 in financial year 2008-09, the requirement under section 44AA to compulsorily maintain the prescribed books of account is not applicable to him.

Students may note that in *A.Keshava Bhat v. ITO (2001) 247 ITR 83 (Karn)* it was held that the exemption from the coverage of Rule 6F is available where the gross receipt does not exceed the prescribed limit in any one of the three preceding years. Applying this decision the assessee need not maintain books of account as prescribed in rule 6F for the financial years 2010-11 and 2011-12 also.

Question 3

M/s Sidhant & Co., a sole proprietary concern is converted into a company, Sidhant Co. Ltd. with effect from November 29, 2010. The written down value of assets as on April 1, 2010 is as follows:

Items	Rate of Depreciation	WDV as on 1st April, 10
<i>Building</i>	10%	<i>Rs.3,50,000</i>
<i>Furniture</i>	10%	<i>Rs.50,000</i>
<i>Plant and Machinery</i>	15%	<i>Rs.2,00,000</i>

Further, on October 15, 2010, M/s Sidhant & Co. purchased a plant for Rs.1,00,000 (rate of depreciation 15%). After conversion, the company added another plant worth Rs.50,000 (rate of depreciation 15%).

Compute the depreciation available to (i) M/s Sidhant & Co. and (ii) Sidhant Co. Ltd. for Asst. year 2011-12.

Answer

In the case of conversion of sole proprietary concern into a company as per section 47(xiv), the depreciation should be first calculated for the whole year assuming that no succession had taken place. Thereafter, the depreciation should be apportioned between the sole proprietary concern and the company in the ratio of the number of days for which the assets were used by them. It is assumed that in this case, the conditions specified in section 47(xiv) are satisfied.

Taxation

Computation of depreciation allowable to Sidhant & Co. for A.Y.2011-12

Particulars	Rs.	Rs.
Building		
WDV as on 1.4.2010	3,50,000	
Depreciation@10%		35,000
Furniture		
WDV as on 1.4.2010	50,000	
Depreciation@10%		5,000
Plant and Machinery		
WDV as on 1.4.2010	2,00,000	
Add: Additions during the year (purchased on 15.10.10)	1,00,000	
	<u>3,00,000</u>	
Less: Depreciation for the year		
(15% of Rs.2,00,000 + 50% of 15% of Rs.1,00,000)		37,500
(30,000 + 7,500)		
(Depreciation on new machinery is restricted to 50% of eligible depreciation, since the asset is put to use for less than 180 days in that year)		
Total depreciation for the year		<u>77,500</u>

Proportionate depreciation allowable to Sidhant & Co. for 242 days

On existing assets (i.e. 1.4.10 to 28.11.10)	46,411	
(i.e. $242/365 \times \text{Rs.}70,000$)		
On new machine for 45 days i.e., $\left(\frac{45}{168} \times 7,500\right)$	<u>2,009</u>	48,420

Computation of depreciation allowable to Sidhant Co. Ltd. for A.Y.2011-12

Particulars	Rs.	Rs.
(i) Depreciation on the assets on conversion		
Proportionately for 123 days i.e. after conversion period		
$(123/365 \times \text{Rs.}70,000) + (123/168 \times 7,500) = 23,589 + 5,491$		29,080

Profits and Gains of Business or Profession

(ii) Depreciation @ 50% of normal rate of 15% on Rs.50,000, being the value of plant purchased after conversion, which was put to use for less than 180 days	3,750
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Depreciation allowable to Sidhant Co. Ltd.	32,830
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Note: Since it has not been specifically mentioned that M/s Sidhant & Co. and Sidhant & Co. Ltd. are manufacturing concerns, additional depreciation is not provided for.

Question 4

Following is the profit and loss account of Mr. A for the year ended 31.3.2011:

	Rs.		Rs.
To Repairs on building	1,30,000	By Gross profit	6,01,000
To Advertisement	51,000	By IncomeTax Refund	4,500
To Amount paid to Scientific Research Association approved u/s 35	1,00,000	By Interest from company deposits	6,400
To Interest	1,10,000	By Dividends	3,600
To Traveling	1,30,000		
To Net Profit	94,500		
	<u>6,15,500</u>		<u>6,15,500</u>

Following additional information is furnished:

- (1) Repairs on building includes Rs.95,000 being cost of raising a compound wall for the own business premises.
- (2) Interest payments include interest of Rs.12,000 payable outside India to a resident Indian on which tax has not been deducted and penalty of Rs.24,000 for contravention of Central Sales Tax Act.

Compute the income chargeable under the head 'Profits and gains of business or profession' of Mr. A for the year ended 31.3.2011 ignoring depreciation.

Answer

Profits and gains of business or profession of Mr. A for the year ended 31.3.2011

Particulars	Rs.	Rs.
Net profit as per profit and loss account		94,500
Add: Expenses not allowable		
(i) Expenses on raising compound wall – capital expenditure, hence disallowed	95,000	

Taxation

(ii) Interest payable outside India to a resident, as tax has not been deducted at source [Section 40(a)]	12,000	
(iii) Penalty for contravention of CST Act [Penalty paid for violation or infringement of any law is not allowable as deduction under section 37(1)]	24,000	
(iv) Contribution for scientific research (to be treated separately)	1,00,000	2,31,000
		3,25,500
Less: Income not forming part of business income		
Interest from company deposits	6,400	
Dividend	3,600	
Income Tax refund	4,500	14,500
		3,11,000
Less: Deduction under section 35 for scientific research [See Note below]		1,75,000
Profit and gains of business or profession		1,36,000

Note: Contribution to approved scientific research association qualifies for deduction @ 175% under section 35(1)(ii).

Question 5

Briefly discuss about the provisions relating to deductibility of interest on capital borrowed for the purpose of business or profession.

Answer

Under section 36(1)(iii), deduction is allowed in respect of interest on capital borrowed for the purposes of business or profession while computing income under the head "Profits and gains of business or profession".

Further, Explanation 8 to section 43(1) clarifies that interest relatable to a period after the asset is first put to use cannot be capitalized. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should, however, be capitalized in the case of extension of existing business or profession.

The proviso to section 36(1)(iii) provides that no deduction shall be allowed in respect of any amount of interest paid, in respect of capital borrowed for acquisition of a new asset or for extension of existing business or profession (whether capitalized in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset, till the date on which such asset was first put to use.

Question 6

- (i) *Deductibility of contributions for Rural Development Programmes under section 35CCA.*
- (ii) *State the provisions relating to expenditure by way of payment to institutions carrying rural development programmes.*

Answer

See page 4.130 of Study Material.

Question 7

Explain briefly the tax treatment of compensation received in restraint of trade, under section 28(va).

Answer

Compensation received in restraint of trade is an income chargeable to tax under the head "Profits and gains of business or profession" as per the provisions of section 28(va). Also, section 2(24) which defines "income" includes any sum referred to in section 28(va).

It includes any sum whether received or receivable, in cash or kind, under an agreement for :

- (a) not carrying out any activity in relation to any business; or
- (b) not sharing any know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

However, clause (a) given above will not cover :

- (i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business which is chargeable under the head "Capital gains".
- (ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone Layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with Government of India.

In the above context, it is to be noted that :

- (i) "agreement" includes any arrangement or understanding or action in concert, whether or not the same is formal or in writing or whether it is intended to be enforceable by legal proceedings.
- (ii) "service" would mean service of any description which is made available to potential users. It includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging.

Taxation

Question 8

What are intangible assets? Give four examples. What is the rate of depreciation on a block of intangible assets?

Answer

Intangible assets are assets which are not corporeal i.e., not capable of being touched. Such assets are represented by rights of the persons through them.

According to Explanation 3(b) to section 32(1), the following are intangible assets :

- (a) Know-how
- (b) Patents
- (c) Copyrights
- (d) Trade Marks
- (e) Licences
- (f) Franchises
- (g) any other business or commercial rights of similar nature.

They are to be depreciated at the rate of 25%.

Question 9

Mr. Sukhvinder is engaged in the business of plying goods carriages. On 1st April, 2010, he owns 10 trucks (out of which 6 are heavy goods vehicles). On 2nd May, 2010, he sold one of the heavy goods vehicles and purchased a light goods vehicle on 6th May, 2010. This new vehicle could however be put to use only on 15th June, 2010.

Compute the total income of Mr. Sukhvinder for the assessment year 2011-12, taking note of the following data :

	Rs.	Rs.
Freight charges collected		8,70,000
Less : Operational expenses	6,25,000	
Depreciation as per section 32	1,85,000	
Other office expenses	15,000	
		<u>8,25,000</u>
Net Profit		<u>45,000</u>
Other business and non – business income		<u>70,000</u>

Answer

Section 44AE would apply in the case of Mr. Sukhvinder since he is engaged in the business of plying goods carriages and owns not more than ten goods carriages at any time during the previous year.

Section 44AE provides for computation of business income of such assessee on a presumptive basis. The income shall be deemed to be Rs.5,000 from a heavy goods vehicle and Rs.4,500 from a vehicle other than a heavy goods vehicle - for every month or part the month during which such goods vehicle is owned by the assessee in the previous year or such higher sums as declared by the assessee in his return of income.

Mr. Sukhvinder's business income calculated applying the provisions of section 44AE is Rs.5,75,500 (See Notes 1 & 2 below) and his total income would be Rs.6,45,500.

However, as per section 44AE(7), Mr. Sukhvinder may claim lower profits and gains if he keeps and maintains proper books of account as per section 44AA and gets the same audited and furnishes a report of such audit as required under section 44AB. If he does so, then his income for tax purposes from goods carriages would be Rs.45,000 instead of Rs.5,75,500 and his total income would be Rs.1,15,000.

Notes :

1. Computation of total income of Mr. Sukhvinder for A.Y. 2011-12

<i>Particulars</i>	<i>Presumptive income</i>	<i>Where books are maintained</i>
Income from business of plying goods carriages [See Note 2 Below]	5,75,500	45,000
Other business and non business income	70,000	70,000
Total Income	6,45,500	1,15,000

2. Calculation of presumptive income as per section 44AE

<i>Type of carriage</i>	<i>No. of months</i>	<i>Rate per month</i>	<i>Amount</i>
(1)	(2)	(3)	(4)
4 light goods vehicle – held throughout the year	12	4,500	2,16,000
1 heavy goods vehicle – held upto 2 nd May	2	5,000	10,000
5 heavy goods vehicle – held throughout the year	12	5,000	3,00,000
1 light goods vehicle – held from 6 th May	11	4,500	49,500
		Total	5,75,500

Taxation

Question 10

A car purchased by S on 10.8.2006 for Rs.3,25,000 for personal use is brought into the business of the assessee on 01.12.2010, when its market value is Rs.1,50,000.

Compute the actual cost of the car and the amount of depreciation for the Assessment year 2011-2012 assuming the rate of depreciation to be 15%.

Answer

In this case, the car was purchased for personal use on 10.8.2006 for Rs.3,25,000 and subsequently brought into the business of the assessee on 1.12.2010. The "actual cost" of car is Rs.3,25,000.

Explanation 5 to section 43(1) provides for determination of "actual cost" of building used for private purposes subsequently brought into business. This Explanation does not apply to any other asset in as much as it refers only to buildings.

The admissible depreciation for A.Y.2011-12 is Rs.48,750 (i.e.15% of Rs.3,25,000). As the car was not acquired during the previous year 2010-11, full depreciation is available for the year even if it is put to use for less than 180 days during the previous year. The condition of restricting depreciation to 50% of the prescribed percentage would apply only where the asset was acquired by the assessee in the previous year.

Question 11

Gopichand Industries furnishes you the following information :

		(Rupees)
Block I	Plant and machinery (consisting of 10 looms)	5,00,000
	Rate of depreciation 15% WDV	
Block II	Buildings (consisting of 3 buildings) WDV	12,50,000
	Rate of depreciation 10%	
	Acquired on 5.07.10 – 5 looms for	4,00,000
	Sold on 7-12-10 – 15 looms for	10,00,000
	Acquired on 10-01-11 – 2 looms for	3,00,000

Compute depreciation claim for the Assessment year 2011-12.

Answer

Computation of depreciation for Gopichand Industries for A.Y.2011-12

Particulars	Rs.	Rs.
Block 1 : Plant & machinery (Rate of depreciation – 15%)		
WDV as on 1 st April (10 looms)	5,00,000	

Profits and Gains of Business or Profession

Add : Additions during the year 5 looms acquired on 5 th July	4,00,000	
2 looms acquired on 10 th January	3,00,000	
	<u>12,00,000</u>	
Less : Assets sold during the year 15 looms sold on 7 th December	10,00,000	
W.D.V. as on 31 st March (2 looms)	<u>2,00,000</u>	
Depreciation on Rs.2 lakhs @ 15% (limited to 50%)		15,000
Additional depreciation (See Note 2)		20,000
Block II:Buildings (Rate of depreciation – 10%)		
WDV as on 1 st April (3 buildings)	12,50,000	
Depreciation on Rs.12,50,000 @ 10%		<u>1,25,000</u>
Total depreciation for the year		<u>1,60,000</u>

Note :

1. Closing balance of Block 1 : Plant and machinery represents the looms acquired on 10th January. These looms have been put to use or less than 180 days during the previous year, and therefore, only 50% of normal depreciation is permissible.
2. Additional depreciation @ 20% of the cost of plant and machinery is available under section 32(1)(ia). In this case, the assessee is eligible for additional depreciation if it is engaged in the business of manufacture or production of any article or thing and satisfies other conditions contained in the provision. It is assumed that all other conditions contained in the section 32(1)(ia) have been fulfilled. The quantum of additional depreciation allowable would be :

$$\text{Rs.2,00,000} \times 20\% \times 50\% \text{ (put to use for less than 180 days)} = \text{Rs.20,000}$$

Question 12

M/s. QQ & Co., a sole proprietary concern, was converted into a company on 1.9.2010. Before the conversion, the sole proprietary concern had a Block of Plant and Machinery (Rate of depreciation 15%), whose WDV as on 1.4.2010 was Rs.3,00,000. On 1st April itself, a new plant of the same block was purchased for Rs.1,20,000. After the conversion, the company has purchased the same type of Plant on 1.1.2011 for Rs.1,60,000.

Compute the depreciation that would be allocated between the sole proprietary concern and the successor company.

Answer

Computation of depreciation in the case of transfer of business.

Depreciation is to be calculated as if there is no succession.

Taxation

WDV as on 1 st April	3,00,000
Add : Additions made before succession	1,20,000
	4,20,000
Less : Sale consideration of the asset sold	Nil
	4,20,000
Depreciation @ 15%	63,000

Allocation of depreciation between sole proprietary concern and the successor company

The depreciation of Rs.63,000 is to be allocated in the ratio of number of days the assets were used by the sole proprietary concern and the company.

Ex-sole proprietary concern

1st April to 31st August = 153 days

$$63,000 \times 153 / 365 = 26,408$$

Successor company

$$63,000 \text{ minus } 26,408 = 36,592 \text{ (i.e. Rs.63,000} \times 212 / 365)$$

The depreciation of Rs.12,000 [50% of 15% on Rs.1,60,000] in respect of asset purchased by the successor company on 1st January is fully allowable in the hands of the successor company.

Note : Since it has not been specified that the company is a manufacturing company, additional depreciation has not been provided for.

Question 13

Mr. Sivam, a retail trader of Cochin gives the following Trading and Profit and Loss Account for the year ended 31st March, 2011:

Trading and Profit and Loss Account for the year ended 31.03.2011

	Rs.		Rs.
To Opening stock	90,000	By Sales	12,11,500
To Purchases	10,04,000	By Income from UTI	2,400
To Gross Profit	3,06,000	By Other business receipts	6,100
		By Closing stock	1,80,000
	14,00,000		14,00,000
To Salary	60,000	By Gross profit b/d	3,06,000
To Rent and rates	36,000		
To Interest on loan	15,000		

Profits and Gains of Business or Profession

To Depreciation	1,05,000	
To Printing & stationery	23,200	
To Postage & telegram	1,640	
To Loss on sale of shares (Short term)	8,100	
To Other general expenses	7,060	
To Net Profit	50,000	
	<u>3,06,000</u>	<u>3,06,000</u>

Additional Information :

- (i) It was found that some stocks were omitted to be included in both the Opening and Closing Stock, the values of which were :

Opening stock Rs.9,000

Closing stock Rs.18,000

- (ii) Salary includes Rs.10,000 paid to his brother, which is unreasonable to the extent of Rs.2,000.

- (iii) The whole amount of printing and stationery was paid in cash.

- (iv) The depreciation provided in the Profit and Loss Account Rs.1,05,000 was based on the following information :

The written down value of plant and machinery is Rs.4,20,000. A new plant falling under the same Block of depreciation of 25% was bought on 1.7.2010 for Rs.70,000. Two old plants were sold on 1.10.2010 for Rs.50,000.

- (v) Rent and rates includes sales tax liability of Rs.3,400 paid on 7.4.2011.

- (vi) Other business receipts include Rs.2,200 received as refund of sales tax relating to 2009-10.

- (vii) Other general expenses include Rs.2,000 paid as donation to a Public Charitable Trust.

You are required to advise Mr. Sivam whether he can offer his business income under section 44AD i.e. presumptive taxation.

Answer

Computation of business income of Mr. Sivam for the A.Y. 2011-12.

	Rs.	Rs.
Net Profit as per profit and loss account		50,000

Taxation

<i>Add</i>	Inadmissible expenses / losses		
	Under valuation of closing stock	18,000	
	Salary paid to brother – unreasonable [Section 40A(2)]	2,000	
	Printing and stationery paid in cash [Section 40A(3)]	23,200	
	Depreciation (considered separately)	1,05,000	
	Short term capital loss on shares	8,100	
	Donation to public charitable trust	2,000	1,58,300
			2,08,300
<i>Less</i>	Deductions items:		
	Under valuation of opening stock	9,000	
	Income from UTI [Exempt u/s 10(35)]	2,400	
	Refund of sales tax [Taxable u/s.41(1) – No adjustment necessary]	--	11,400
	Business income before depreciation		1,96,900
<i>Less</i>	Depreciation (See Note 1)		66,000
			1,30,900

Computation of business income as per section 44AD

As per section 44AD, the business income would be 5% of turnover i.e., $12,11,500 \times 8 / 100 = \text{Rs.}96,920$

The business income under section 44AD is **Rs.96,920**.

As the business income under section 44AD is lower than the business income as per the normal provisions of the Act, it is advisable for Mr. Sivam to offer his business income under section 44AD of the Act.

Note 1

Calculation of depreciation

WDV of the block of plant & machinery as on 1.4.2010	4,20,000
<i>Add</i> :Cost of new plant & machinery	70,000
	4,90,000
<i>Less</i> : Sale proceeds of assets sold	50,000
	4,40,000
WDV of the block of plant & machinery as on 31.3.2011	4,40,000
Depreciation @ 15%	66,000

No additional depreciation is allowable as the assessee is not engaged in manufacture or production of any article.

Note 2

Since sales-tax liability has been paid before the due date of filing return of income under section 139(1), the same is deductible.

Question 14

Discuss the provisions of tax audit under section 44AB of the Income-tax Act, 1961.

Answer

See page 4.176 of Study Material.

Question 15

State with reasons, whether the following statements are true or false, with regard to the provisions of the Income-tax Act, 1961:

- (a) *Payment made in respect of a business expenditure incurred on 16th February, 2011 for Rs.25,000 through a cheque duly crossed as "& Co." is hit by the provisions of section 40A(3).*
- (b) (i) *It is a condition precedent to write off in the books of account, the amount due from debtor to claim deduction for bad debt.*
(ii) *Failure to deduct tax at source in accordance with the provisions of Chapter XVII-B, inter alia, from the amounts payable to a resident as rent or royalty, will result in disallowance while computing the business income.*
- (c) *Co-operative banks are not allowed to claim provision for bad and doubtful debts in respect of advances made by rural branches of such banks.*
- (d) *Where the payment is made in cash by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payer, in excess of Rs.20,000 in a day, no disallowance gets attracted under section 40A(3) of the Income-tax Act, 1961, read with Rule 6DD of the Income-tax Rules, 1962.*

Answer

(a) True

In order to escape the disallowance specified in section 40A(3), payment in respect of the *business* expenditure ought to have been made through an account payee cheque. Payment through a cheque crossed as "& Co." will attract disallowance under section 40A(3).

(b) (i) True

It is mandatory to write off the amount due from a debtor as not receivable, in order to claim the same as bad debt under section 36(1)(vii).

Taxation

(ii) True

Section 40(a)(ia) provides that failure to deduct tax at source from rent or royalty payable to a resident, in accordance with the provisions of Chapter XVII-B, will result in disallowance of such expenditure.

(c) False

Sub-clause (a) of section 36(1)(viiia) allows the co-operative banks to claim deduction for provision for bad and doubtful debts in respect of advances made by rural branches of such banks. However, the deduction should not exceed 10% of the aggregate average advances made by the rural branches of such banks computed in the prescribed manner.

(d) True

As per Rule 6DD, no disallowance gets attracted under section 40A(3) of the Income-tax Act, 1961, where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee.

Alternate Answer

Since the question mentions that the payment is made in cash by way of adjustment, it is possible to take a view that the net amount after adjustment was made in cash and since such net payment exceeds Rs.20,000 in a day, disallowance under section 40A(3) would be attracted. If such a view is adopted, the statement would be false.

Question 16

Swadeshi Ltd., which follows mercantile system of accounting, obtained licence on 1.6.2010 from the Department of telecommunication for a period of 10 years. The total licence fee payable is Rs.18,00,000. The relevant details are:

Year ended 31 st March	Licence fee payable for the year	Payments made	
		Date	Amount
	Rs.		Rs.
2010	10,00,000	30.03.10	3,70,000
		15.05.10	6,30,000
2011	8,00,000	28.02.11	5,40,000

Balance of Rs.2,60,000 is pending as on 31.3.2011.

Compute the amount of deduction available to the assessee under section 35ABB for the assessment years 2010-11 and 2011-12. Can any deduction be claimed under section 32 also?

Answer

As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services, shall be allowed as deduction in equal installments during the number of years for which the licence is in force. Therefore, the year of actual payment is relevant and not the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.

1. Rs. 3,70,000 paid on 30.03.2010 [P.Y.2009-10]

Unexpired period of licence 10 years

Hence Rs.37,000 [i.e. Rs.3,70,000/10] can be claimed under section 35ABB for period of 10 years commencing from A.Y.2010-11.

2. Rs.11,70,000 paid during year ended 31.03.11 [P.Y.2010-11]

Unexpired period of licence 9 years

Hence, Rs.1,30,000 [i.e. Rs.11,70,000/9] can be claimed under section 35ABB for a period of 9 years commencing from A.Y.2011-12.

3. Amount of deduction u/s 35ABB

Assessment year	Amount (Rs.)
2010-11	37,000
2011-12	37,000 + 1,30,000 = 1,67,000

- 4.** Where deduction under section 35ABB is claimed and allowed, deduction under section 32(1) cannot be allowed for the same previous year or any subsequent previous year

Question 17

X Ltd. follows mercantile system of accounting. After negotiations with the bank, interest of Rs.4 lakhs (including interest of Rs.1.2 lakhs pertaining to year ended 31.03.2011) has been converted into loan. Can the interest of Rs.1.2 lakhs so capitalized be claimed as business expenditure?

Answer

Under section 43B, interest on term loans and advances to scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee.

Taxation

Explanation 3D to section 43B provides that if any interest payable by the assessee is converted into a loan, the interest so converted and not “actually paid” shall not be deemed as actual payment, and hence would not be allowed as deduction. Therefore, the interest of Rs.1.2 lakhs converted into loan cannot be claimed as business expenditure.

Question 18

Vivitha Bio-medicals Ltd. is engaged in the business of manufacture of bio-medical items. The following expenses were incurred in respect of activities connected with scientific research:

<i>Year ended</i>	<i>Item</i>	<i>Amount (Rs.)</i>
31.03.2008	Land	10,00,000
(Incurred after 1.9.2007)	Building	25,00,000
31.03.2009	Plant and machinery	5,00,000
31.03.2010	Raw materials	2,20,000
31.03.2011	Raw materials and salaries	1,80,000

The business was commenced on 01-09-2010.

In view of availability of better model of plant and machinery, the existing plant and machinery were sold for Rs. 8,00,000 on 1.03.2011.

Discuss the implications of the above for the assessment year 2011-12 along with brief computation of deduction permissible under section 35 assuming that necessary conditions have been fulfilled. You are informed that the assessee's line of business is eligible for claiming deduction under section 35 at 200% on eligible items.

Answer

1. As per section 35, where a company engaged in, *inter alia*, the business of biotechnology incurs any expenditure on scientific research during the current year, it is eligible for claiming weighted deduction of a sum equal to 200% of the eligible expenditure.

The eligible expenditure and quantum of deduction will be:

- (a) Current year capital or revenue expenditure incurred for scientific research (weighted deduction @ 200%).
- (b) Any expenditure incurred during earlier 3 years immediately preceding the date of commencement of business on payment of salary or purchase of materials, or capital expenditure incurred other than expenditure on acquisition of land [actual expenditure qualifies for deduction under section 35(1)].

The deduction available under section 35 for scientific research will, therefore, be:

Particulars	Rs.
(a) Land	Nil
(b) Building	25,00,000
(c) Revenue expenses of last 3 years	2,20,000
(d) Capital expenditure of last 3 years: Plant and machinery	5,00,000
Expenditure allowable under section 35(1)	32,20,000
Current year revenue expenditure Rs.1,80,000 [200% of Rs.1,80,000 is allowable under section 35(2AB)]	3,60,000
Total deduction under section 35	35,80,000

2. Section 41(3) provides that where a capital asset used for scientific research is sold, without having been used for other purposes, the lower of sale proceeds or the total amount of deduction earlier allowed under section 35 will be considered as income from business of the previous year in which the sale took place.

Therefore, the income chargeable to tax under section 41(3) should be lower of the following:

(1) Sale proceeds i.e. Rs. 8,00,000

(2) Total amount of deduction earlier allowed under section 35 i.e. Rs. 5,00,000

Rs. 5,00,000 will be deemed to be the income chargeable to tax under section 41(3).

3. The difference between sale proceeds and business income under section 41(3) will be treated as short-term capital gain.

Sale proceeds of plant and machinery	8,00,000
Less: Business Income as per section 41(3)	<u>5,00,000</u>
Short-term capital gain	<u>3,00,000</u>

Question 19

Mr. B.A. Patel, a non-resident, operates an aircraft between London to Ahmedabad. For the Financial year ended on 31st March, 2011, he received the amounts as under:

- (i) *For carrying passengers from Ahmedabad Rs. 50 lacs.*
- (ii) *For carrying passengers from London Rs. 75 lacs received in India.*
- (iii) *For carrying of goods from Ahmedabad Rs. 25 lacs.*

The total expenditure incurred by Mr. B.A. Patel for the purposes of the business for the financial year 2010-11 was Rs. 1.4 crores.

Taxation

Compute the income of Mr. B.A. Patel under the head "Profits and Gains from business or profession" for the financial year ended on 31st March 2011 relevant to assessment year 2011-12.

Answer

Under section 44BBA, in case of an assessee, being a non-resident, engaged in the business of operation of aircraft, a sum equal to 5% of the aggregate of the following amounts shall be deemed to be his business income:

- (a) the amount paid or payable, whether in or out of India, to the assessee on account of carriage of passengers, goods etc. from any place in India; and
- (b) the amount received or deemed to be received in India by the assessee on account of carriage of passengers, goods etc. from any place outside India.

Hence, the income of Mr. B.A. Patel chargeable to tax in India under the head "Profits and Gains of business or profession" is determined as under:

Particulars	Rs.
(i) For carrying passengers from Ahmedabad	50,00,000
(ii) For carrying passengers from London, amount received in India	75,00,000
(iii) For carrying goods from Ahmedabad	25,00,000
Total	1,50,00,000

Hence, income from business computed on presumptive basis as per section 44BBA is Rs. 7,50,000, being 5% of Rs.1,50,00,000.

Note: No deduction is allowable in respect of any expenditure incurred for the purpose of the business.

Question 20

Comment on the allowability of the following claim made by the assessee:

Mr. Achal, a hotelier, claimed expenditure on replacement of Linen and carpets in his hotel as revenue expenditure.

Answer

The expenditure on replacement of linen and carpets in a hotel are in the nature of expenses incurred for the business and are allowable as revenue expenses under section 37(1).

Question 21

List six items of expenses which otherwise are deductible shall be disallowed, unless payments are actually made within the due date for furnishing the return of income under Section 139(1). When can the deduction be claimed, if paid after the said date?

Answer

Section 43B provides that the following expenses shall not be allowed as deduction unless the payments are actually made within the due date for furnishing the return of income under section 139(1):

- (i) Any tax, duty, cess or fees under any law in force.
- (ii) Employer's contribution to provident fund or superannuation fund or gratuity fund or any other fund for the welfare of the employees;
- (iii) Any bonus or commission for services rendered payable to employees;
- (iv) Any interest on any loan or borrowings from any public financial institution or State financial corporation or State industrial investment corporation;
- (v) Interest on loans and advances from a scheduled bank;
- (vi) Any sum paid as an employer in lieu of earned leave at the credit of his employee.

In case the payment is made after the due date of filing of return of income, deduction can be claimed only in the year of actual payment.

Question 22

Briefly explain the term "substantial interest". State any two situations in which the same assumes importance.

Answer

As per Explanation to section 40A(2), a person shall be deemed to have a substantial interest in a business or profession, if, -

- (1) in case where the business or profession is carried on by a company, such person is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend, whether with or without a right to participate in profits), carrying not less than 20% of the voting power.
- (2) In any other case, such person is beneficially entitled to not less than 20% of the profits of such business or profession.

Following are the situations under which the substantial interest assumes importance

- (i) Taxability of deemed dividend under section 2(22)(e);
- (ii) Disallowance of excessive or unreasonable expenditure under section 40A(2) to an individual who has a substantial interest in the business or profession of the assessee, and
- (iii) Clubbing of salary income of spouse, under section 64(1)(ii) in respect of remuneration received by the spouse from a concern in which the individual has a substantial interest.

Taxation

Question 23

Mr. Tony had estates in Rubber, Tea and Coffee. He derives income from them. He has also a nursery wherein he grows and sells plants. For the previous year ending 31.3.2011, he furnishes the following particulars of his sources of income from estates and sale of plants. You are requested to compute the taxable income for the Assessment year 2011-2012:

	Rs.
(i) Manufacture of Rubber	5,00,000
(ii) Manufacture of Coffee grown and cured	3,50,000
(iii) Manufacture of Tea	7,00,000
(iv) Sale of plants from Nursery	1,00,000

Answer

Computation of taxable income of Mr. Tony for A.Y.2011-12

Particulars	Business Income Rs.	Agricultural Income Rs.
(a) Income from manufacture of rubber (Rule 7A)		
Business income is 35% of Rs.5,00,000	1,75,000	
Agricultural income is 65% of Rs.5,00,000		3,25,000
(b) Income from growing and curing of coffee (Rule 7B)		
Business income is 25% of Rs.3,50,000	87,500	
Agricultural income is 75% of Rs.3,50,000		2,62,500
(c) Income from manufacture of tea (Rule 8)		
Business income is 40% of Rs.7,00,000	2,80,000	
Agricultural income is 60% of Rs.7,00,000		4,20,000
(d) Income from sale of plants in nursery is agricultural income [See Note below]	Nil	1,00,000
	5,42,500	11,07,500

Note:

Explanation 3 to Section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income, whether or not the basic operations were carried out on land.

Question 24

Who are the persons and what are the circumstances which require maintaining books of accounts compulsorily? State the period for which such books are required to be kept and maintained.

Answer

Refer to section 44AA in page 4.173 of Study Material.

Question 25

Fill in the blanks:

- (i) *Where a company has incurred a capital expenditure of Rs.1,00,000 towards promoting family planning amongst employees, Rs. will be allowed as deduction in the current year and the balance in succeeding years.*
- (ii) *A motor car is the only asset in a block. Cost Rs.2,00,000. Rate of depreciation is 15%. 20% is disallowed for estimated personal use. WDV of the block is Rs.....*
- (iii) *In case of an eligible assessee, in respect of imported second hand machinery never put to use by any person in India before, additional or accelerated depreciation is allowable at the rate of ----- on the actual cost of machinery.*
- (iv) *A private limited company incurred a capital expenditure of Rs.5,00,000 on 1.4.2010 for acquisition of patents and copyrights, such expenditure is(eligible for deduction in 5 years/subject to depreciation under section 32).*
- (v) *Under section 54EC, capital gains are exempted if invested in the bonds issued by NHAI and RECL within a period of 6 months from the(date of transfer of the asset/end of the previous year).*

Answer

- (i) 20,000, four
- (ii) Rs.1,76,000.
- (iii) Nil / 0 %.
- (iv) subject to depreciation under section 32
- (v) date of transfer of the asset.

Question 26

Choose the correct answer with reference to the provisions of the Income-tax Act, 1961:

Taxation

Under section 44AE, presumptive taxation is applicable at a particular rate provided the assessee is the owner of a maximum of certain number of goods carriages. The rate per month or part of the month and maximum number specified under the section are :

- (a) Rs.5,000 for a heavy goods carriage and Rs.4,500 for other goods carriages for an assessee owning not more than 10 goods carriages at any time during the year*
- (b) Rs.5,000 per carriage for an assessee owning not more than 10 goods carriages at the end of the previous year*
- (c) Rs.3,500 for a heavy goods carriage and Rs.3,150 for other goods carriages for an assessee owning not more than 12 goods carriages at the end of the previous year*
- (d) Rs.3,150 per carriage for an assessee owning not more than 10 goods carriages at the end of the previous year.*

Answer

- (a) Rs.5,000 for a heavy goods carriage and Rs.4,500 for other goods carriages for an assessee owning not more than 10 goods carriages at any time during the year*

Question 27

State with reasons, for the following sub-divisions, whether the following statements are true or false having regard to the provisions of the Income-tax Act, 1961:

- (i) For a dealer in shares and securities, securities transaction tax paid in a recognized stock exchange is permissible business expenditure.*
- (ii) Where a person follows mercantile system of accounting, an expenditure of Rs.25,000 has been allowed on accrual basis and in a later year, in respect of the said expenditure, assessee makes the payment of Rs.25,000 through a cheque crossed "& Co.", disallowance of Rs.25,000 under section 40A(3) can be made in the year of payment.*
- (iii) It is mandatory for an assessee to claim depreciation under section 32 of the Income-tax Act.*
- (iv) The mediclaim premium paid to GIC by Mr. Lomesh for his employees, by a draft, on 27.12.10 is a deductible expenditure under section 36.*
- (v) Under section 35DDA, amortization of expenditure incurred under eligible Voluntary Retirement Scheme at the time of retirement alone, can be done.*
- (vi) An existing assessee engaged in trading activities, can claim additional depreciation under Section 32(1)(iia) in respect of new plant acquired and installed in the trading concern, where the increase in value of such plant as compared to the approved base year is more than 10%.*

Answer

(i) True

Section 36(1)(xv) allows a deduction of the amount of securities transaction tax paid by the assessee in respect of taxable securities transactions entered into in the course of business during the previous year as deduction from the business income of a dealer in shares and securities.

(ii) True

As per section 40A(3), in the case of an assessee following mercantile system of accounting, if an expenditure has been allowed as deduction in any previous year on due basis, and payment exceeding Rs.20,000 has been made in the subsequent year otherwise than by account payee cheque or account payee bank draft, then the payment so made shall be deemed to be the income of the subsequent year in which such payment has been made.

(iii) True

According to the Explanation 5 to section 32(1), allowance of depreciation is mandatory. Therefore, depreciation has to be provided mandatorily while calculating income from business / profession whether or not the assessee has claimed the same while computing his total income.

(iv) True

Section 36(1)(ib) provides deduction in respect of premium paid by an employer to keep in force an insurance on the health of his employees under a scheme framed in this behalf by GIC or any other insurer. The medical insurance premium can be paid by any mode other than cash, to be eligible for deduction under section 36(1)(ib).

(v) False

Expenditure incurred in making payment to the employee in connection with his voluntary retirement either in the year of retirement or in any subsequent year, will be entitled to deduction in 5 equal annual installments beginning from the year in which each payment is made to the employee.

(vi) False

Additional depreciation can be claimed only in respect of eligible plant and machinery acquired and installed by an assessee engaged in the business of manufacture or production of any article or thing. In this case, the assessee is engaged in trading activities and the new plant has been acquired and installed in a trading concern. Hence, the assessee will not be entitled to claim additional depreciation under section 32(1)(iia).

Question 28

Write short notes on:

- (i) Shipping business in case of non-resident.*
- (ii) The circumstances where the provisions of section 40A(3), regarding cash payments in excess of Rs.20,000, does not apply.*
- (iii) Amortisation of expenditure under voluntary retirement scheme.*
- (iv) Restrictions on deductions allowable to the partnership firm in respect of salary and interest to its partners under section 40(b) of the Income-tax Act, 1961.*
- (v) Deduction to be allowed on actual payment basis.*
- (vi) Carry forward and set off of unabsorbed depreciation.*
- (vii) Special provisions under section 44DA for computing income by way of royalty, fee for technical services, etc. in case of non-residents.*
- (viii) Additional depreciation.*

Answer

(i) Shipping business in case of non-resident

See section 44B in page 4.181 of Study Material.

(ii) The circumstances where the provisions of section 40A(3) regarding cash payments in excess of Rs.20,000, do not apply

See Rule 6DD in page 4.159 of Study Material.

(iii) Amortisation of expenditure incurred under voluntary retirement scheme

See section 35DDA in page 4.134 of Study Material

(iv) In the case of a partnership firm, the deduction on account of interest and salary paid to its partners are as subject to the following restrictions contained in section 40(b) -

- (i) It should be authorised by and in accordance with the terms of the partnership deed.
- (ii) It should not relate to a period before the date of such deed.
- (iii) Remuneration should be paid to a working partner.
- (iv) The amounts allowable are subject to the following limits -

(1) In the case of interest

Simple interest up to 12% p.a. is allowable. This restriction is not applicable if a

person is a partner in his representative capacity in the firm and he receives interest from the firm in his individual capacity. Similarly, the restriction is also not applicable if a person who is a partner in his individual capacity receives interest for and on behalf of someone else from the firm in which he is a partner.

- (2) In the case of salary, bonus, commission or remuneration paid by a firm to its working partners – It should not exceed the amount specified in the table below -**

For all firms

- | | | |
|-----|--|--|
| (a) | On the first Rs.3,00,000 of the book profit or in case of loss | Rs.1,50,000 or 90% of book profit, whichever is more |
| (b) | On the balance of the book profit | @ 60% |

- (v)** See section 43B in page 4.169 of Study Material.

- (vi)** Section 32(2) provides for carry forward of unabsorbed depreciation.

Where, in any previous year, the profits or gains chargeable are not sufficient to give full effect to the depreciation allowance, such unabsorbed depreciation shall be added to the depreciation allowance for the following previous year and shall be deemed to be part of that allowance.

If there is no depreciation allowance for that previous year, the unabsorbed depreciation of the earlier previous year shall become the depreciation allowance of that year. The effect of the provisions of section 32(2) is that unabsorbed depreciation brought forward shall be deemed as the current year depreciation. Consequently, such unabsorbed depreciation can be set-off not only against income under the head "Profits and gains of business or profession" but also against income under any other head. Further, the unabsorbed depreciation can be carried forward indefinitely till it is fully set off.

However, in the order of set-off losses under different heads of income, effect shall first be given to current year depreciation, then to brought forward business losses and finally to unabsorbed depreciation.

- (vii)** See page 4.184 of Study Material.

- (viii)** Section 32(1)(ia) provides that in the case of any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing, a further sum equal to 20% of the actual cost of such machinery or plant shall be allowable as a deduction.

The additional depreciation is available to a new machinery or plant used in the manufacture or production of any article or thing. Additional depreciation will be taken into consideration for computing the WDV of the relevant block of assets.

Additional depreciation is not available in respect of the following assets :

(A) any machinery or plant

- (i) which has been used in India or outside India by any other person before its installation by the assessee; or
- (ii) installed in any office premises, residential accommodation including accommodation used in the nature of guest house ; or
- (iii) the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income under the head "Profits and gains of business or profession" of any one previous year.

(B) any office appliances or road transport vehicles.

UNIT 4 : CAPITAL GAINS

Question 1

State, with reasons, whether the following statements are True or False.

- (i) *Alienation of a residential house in a transaction of reverse mortgage under a scheme made and notified by the Central Government is treated as "transfer" for the purpose of capital gains.*
- (ii) *Zero coupon bonds of eligible corporation, held for more than 12 months, will be long-term capital assets.*
- (iii) *In the case of a dealer in shares, income by way of dividend is taxable under the head "Profits and gains of business or profession".*
- (iv) *Where an urban agricultural land owned by an individual, continuously used by him for agricultural purposes for a period of two years prior to the date of transfer, is compulsorily acquired under law and the compensation is fixed by the State Government, resultant capital gain is exempt.*
- (v) *Zero Coupon Bond means a bond on which no payment and benefits are received or receivable before maturity or redemption.*
- (vi) *Income from growing and manufacturing tea in India is treated as agricultural income wholly.*

Answer

(i) False

As per section 47(xvi), such alienation in a transaction of reverse mortgage under a scheme made and notified by the Central Government is not regarded as "transfer" for the purpose of capital gains.

(ii) True

Section 2(42A) defines the term 'short-term capital asset'. Under the proviso to section 2(42A), zero coupon bond held for not more than 12 months will be treated as a short-term capital asset. Consequently, such bond held for more than 12 months will be a long-term capital asset.

Taxation

(iii) False

In view of the provisions of section 56(2)(i), dividend income is taxable under the head "Income from other sources" in the case of all assesseees.

(iv) False

As per section 10(37), where an individual owns urban agricultural land which has been used for agricultural purposes for a period of two years immediately preceding the date of transfer, and the same is compulsorily acquired under any law and the compensation is determined or approved by the Central Government or the Reserve Bank of India, resultant capital gain will be exempt.

In this case, the compensation has been fixed by the State Government and hence the exemption will not be available.

(v) True

As per section 2(48), 'Zero Coupon Bond' means a bond issued by any infrastructure capital company or infrastructure capital fund or a public sector company on or after 1st June 2005, in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and which the Central Government may notify in this behalf.

(vi) False

Only 60% of the income derived from the sale of tea grown and manufactured by the seller in India is treated as agricultural income and the balance 40% of the income shall be non-agricultural income chargeable to tax. [Rule 8 of Income-tax Rules, 1962].

Question 2

Singhania & Co. own six machines, put in use for business in March, 2010. The depreciation on these machines is charged @ 15%. The written down value of these machines at the end of the previous year relevant to Assessment year 2010-11 was Rs.8,50,000. A new plant was bought for Rs.8,50,000 on 30th November, 2010.

Three of the old machines were sold on 10th June, 2010 for Rs.11,00,000.

You are required to:

- (i) determine the claim of depreciation for Assessment Year 2011-12.*
- (ii) compute the capital gains liable to tax for Assessment Year 2011-12.*
- (iii) If Singhania & Co. had sold the three machines in June, 2010 for Rs.21,00,000, will there be any difference in your above workings? Explain.*

Answer

(i) Computation of depreciation for A.Y.2011-12

Particulars	Rs.
W.D.V. of the block as on 1.4.2010	8,50,000
Add: Purchase of new plant during the year	<u>8,50,000</u>
	17,00,000
Less: Sale consideration of old machinery during the year	<u>11,00,000</u>
W.D.V of the block as on 31.03.11	<u>6,00,000</u>

Since the value of the block as on 31.3.11 comprises of a new asset which has been put to use for less than 180 days, depreciation is restricted to 50% of the prescribed percentage of 15% i.e. depreciation is restricted to 7½%. Therefore, the depreciation allowable for the year is Rs.45,000, being 7½% of Rs.6,00,000.

(ii) The provisions under section 50 for computation of capital gains in the case of depreciable assets can be invoked only under the following circumstances:

- (a) When one or some of the assets in the block are re-sold for consideration more than the value of the block.
- (b) When all the assets are transferred for a consideration more than the value of the block.
- (c) When all the assets are transferred for a consideration less than the value of the block.

Since in the first two cases, the sale consideration is more than the written down value of the block, the computation would result in short term capital gains.

In the third case, since the written down value exceeds the sale consideration, the resultant figure would be a short term capital loss.

In the given case, capital gains will not arise as the block of asset continues to exist, and some of the assets are sold for a price which is lesser than the written down value of the block.

(iii) If the three machines are sold in June, 2010 for Rs.21,00,000, then short term capital gains would arise, since the sale consideration is more than the aggregate of the written down value of the block at the beginning of the year and the additions made during the year.

Taxation

Particulars	Rs.	Rs.
Sale consideration		21,00,000
Less:		
W.D.V. of the machines as on 1.4.2010	8,50,000	
Purchase of new plant during the year	<u>8,50,000</u>	<u>17,00,000</u>
Short term capital gains		<u>4,00,000</u>

Question 3

Paulomi has transferred 1,000 shares of Hetal Ltd., (which she acquired at a cost of Rs.10,000 in the financial year 2001-02) to Dhaval, her brother, at a consideration of Rs.2,12,934 on 15.5.2010 privately.

During the financial year 2010-11, she has paid through e-banking Rs.15,000 towards medical premium, Rs.50,000 towards L.I.P. and Rs.25,000 towards PPF.

Assuming she has no other source of income, compute her total income and tax payable for the Assessment Year 2011-12.

Cost Inflation Index:

F.Y.2001- 02 - 426

F.Y.2010- 11 - 711

Answer

Computation of total income and tax liability of Paulomi for Assessment year 2011-12

Particulars	Rs.
Sale consideration	2,12,934
Less: Indexed cost of acquisition $10,000 \times \frac{711}{426}$	<u>16,690</u>
Long term capital gain	<u>1,96,244</u>
Total income	1,96,240
Tax liability	Rs.
Income-tax @ 20% on Rs.6,240 [Rs.1,96,240 – Rs.1,90,000]	1,248
Add: Education Cess @ 2%	25
Secondary and Higher Education Cess @ 1%	<u>12</u>
Total tax liability	<u>1,285</u>

Notes :

1. As per section 112, deductions under Chapter VI-A are not allowable against long term capital gain. Therefore, Paulomi is not entitled to deduction under section 80C in respect of payment of LIP and contribution to PPF. She is also not entitled to deduction under section 80D in respect of medical insurance premium paid by her.
2. Since Paulomi has not transferred her shares through the Stock Exchange and, therefore, has not paid securities transaction tax, she is not entitled to claim exemption under section 10(38) in respect of long term capital gain.
3. She is, however, entitled to reduce the long-term capital gain by the unexhausted basic exemption limit and pay tax on the balance @20% as per section 112. In this case, since she has no other source of income, the entire basic exemption limit of Rs.1,90,000 can be reduced from the long-term capital gain. It is presumed that Paulomi is a resident assessee.

Question 4

Write short notes on:

- (i) *Special provision for computation of capital gains in the case of slump sale.*
- (ii) *Special provision for full value of consideration in certain cases, in the context of capital gains liability.*

Answer

- (i) Refer to section 50B in page 4.233-4.234 of Study Material.
- (ii) Refer to section 50C in page 4.234-4.235 of Study Material.

Question 5

Aarav converts his plot of land purchased in July, 2001 for Rs.80,000 into stock-in-trade on 31st March, 2010. The fair market value as on 31.3.2010 was Rs.1,90,000. The stock-in-trade was sold for Rs.2,25,000 in the month of January, 2011.

Find out the taxable income, if any, and if so under which 'head of income' and for which Assessment Year?

Cost Inflation Index:

<i>F.Y. 2001 – 2002</i>	<i>- 426</i>
<i>F.Y. 2009 – 2010</i>	<i>- 632</i>
<i>F.Y. 2010 – 2011</i>	<i>- 711</i>

Taxation

Answer

Conversion of a capital asset into stock-in-trade is a transfer within the meaning of section 2(47) in the previous year in which the asset is so converted. However, the capital gains will be charged to tax only in the year in which the stock-in-trade is sold.

The cost inflation index of the financial year in which the conversion took place should be considered for computing indexed cost of acquisition. Further, the fair market value on the date of conversion would be deemed to be the full value of consideration for transfer of the asset as per section 45(2). The sale price less the fair market value on the date of conversion would be treated as the business income of the year in which the stock-in-trade is sold.

Therefore, in this problem, both capital gains and business income would be charged to tax in the A.Y. 2011-12.

Particulars	Rs.
Capital Gains	
Full value of consideration (Fair market value on the date of conversion)	1,90,000
Less: Expenses on transfer	Nil
Net sale consideration	1,90,000
Less: Indexed cost of acquisition $\left[\frac{\text{Rs.80,000} \times 632}{426} \right]$	1,18,685
Long-term capital gain	71,315
Profits & Gains of Business or Profession	
Sale price of stock-in-trade	2,25,000
Less: Fair market value on the date of conversion	1,90,000
	35,000
Computation of taxable income of Mr. Aarav for A.Y.2011-12	
Particulars	Rs.
Profits and gains from business or profession	35,000
Long term capital gains	71,315
	1,06,315

Question 6

Explain the computation of capital gain in case of depreciable asset under section 50.

Answer

See page 4.233 of Study Material.

Question 7

What do you understand by the reference to Valuation Officer under section 55A of the Income-tax Act, 1961?

Answer

See page 4.247 of Study Material.

Question 8

Discuss the tax implications arising consequent to conversion of a capital asset into stock-in-trade of business and its subsequent sale.

Answer

The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock-in-trade. However, as per section 45(2), the profits or gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock-in-trade is sold. For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

On subsequent sale of such stock-in-trade, business profits would arise. The business income chargeable to tax would be the difference between the price at which the stock-in-trade is sold and the fair market value on the date of conversion of the capital asset into stock-in-trade.

Question 9

What is the cost of acquisition of self-generated assets, for the purpose of computation of capital gains?

Answer

1. **Cost of acquisition of a capital asset, being goodwill of a business or a trade mark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, tenancy rights, stage carriage permits and loom hours [Section 55(2)(a)]**
 - (i) If the above capital assets have been purchased by the assessee, the cost of acquisition is the amount of the purchase price. For example, if Mr. A purchases

Taxation

a stage carriage permit from Mr. B for Rs.2 lacs, that will be the cost of acquisition for Mr. A.

- (ii) If the above capital assets are self-generated, the cost of acquisition shall be taken as nil.
- (iii) In case the capital asset is acquired by any mode given under clauses (i) to (iv) of section 49(1), the cost of acquisition will be the cost to the previous owner if the previous owner paid for it. However, if it was self-generated by the previous owner, the cost of acquisition will be taken as nil.

2. Cost of acquisition of other self-generated assets not covered under section 55(2)(a):

In respect of self-generated goodwill of a profession and other self-generated assets not specifically covered under section 55(2)(a), the decision of the Supreme Court in *CIT v. B.C. Srinivasa Setty [1981] 128 ITR 294* will apply. In that case, the Supreme Court held that if the cost of acquisition of a self-generated asset is incapable of determination, then transfer of such asset is not taxable and consequently the gains thereon cannot be brought to charge.

Question 10

Mr. Malik owns a factory building on which he had been claiming depreciation for the past few years. It is the only asset in the block. The factory building and land appurtenant thereto were sold during the year. The following details are available.

	Rs.
<i>Building completed in September, 2006 for</i>	<i>10,00,000</i>
<i>Land appurtenant thereto purchased in April, 2000 for</i>	<i>12,00,000</i>
<i>Advance received from a prospective buyer for land in May, 2001, forfeited in favour of assessee, as negotiations failed</i>	<i>50,000</i>
<i>WDV of the building block as on 1.4.2010</i>	<i>8,74,800</i>
<i>Sale value of factory building in November, 2010</i>	<i>8,00,000</i>
<i>Sale value of appurtenant land</i>	<i>25,00,000</i>

The assessee is ready to invest in long-term specified assets under section 54EC, within specified time.

Compute the amount of taxable capital gain for the assessment year 2011-12 and the amount to be invested under section 54EC for availing the maximum exemption.

Capital Gains

Cost inflation indices are as under :

Financial Year	Cost inflation index
2000-01	406
2001-02	426
2011-12	711

Answer

Computation of taxable capital gain of Mr. Malik for A.Y.2011-12

Particulars	Rs.	Rs.
Factory building		
Sale price of building	8,00,000	
Less: WDV as on 1.4.2010	8,74,800	
		(-) 74,800
Short-term capital loss on sale of building		
Land appurtenant to the above building		
Sale value of land	25,00,000	
Less: Indexed cost of acquisition		
11,50,000 × 711/406	20,13,916	
Long-term capital gains on sale of land		4,86,084
Chargeable long term capital gain		4,11,284

Investment under section 54EC

In this case, both land and building have been held for more than 36 months and hence, are long-term capital assets. Exemption under section 54EC is available if the capital gains arising from transfer of a long-term capital asset are invested in long-term specified assets like bonds of National Highways Authority of India and Rural Electrification Corporation Ltd., within 6 months from the date of transfer. As per section 54EC, the amount to be invested for availing the maximum exemption is the net amount of capital gain arising from transfer of long-term capital asset, which is Rs.4,11,284 in this case.

Notes :

1. Where advance money has been received by the assessee, and retained by him, as a result of failure of the negotiations, section 51 will apply. The advance retained by the assessee will go to reduce the cost of acquisition. Indexation is to be done on the cost of acquisition so arrived at after reducing the advance money forfeited.

Taxation

2. Factory building on which depreciation has been claimed, is a depreciable asset. Profit / loss arising on sale is deemed to be short-term capital gain/loss as per section 50, and no indexation benefit is available.
3. Land is not a depreciable asset, hence section 50 will not apply. Being a long-term capital asset (held for more than 36 months), indexation benefit is available.
4. As per section 74, short term capital loss can be set-off against any income under the head "Capital gains", long-term or short-term. Therefore, in this case, short-term capital loss of Rs.74,800 can be set-off against long-term capital gain of Rs.4,86,084.

Question 11

Mr. A is an individual carrying on business. His stock and machinery were damaged and destroyed in a fire accident.

The value of stock lost (total damaged) was Rs.6,50,000. Certain portion of the machinery could be salvaged. The opening WDV of the block as on 1-4-2010 was Rs.10,80,000.

During the process of safeguarding machinery and in the fire fighting operations, Mr. A lost his gold chain and a diamond ring, which he had purchased in April, 2002 for Rs.1,20,000. The market value of these two items as on the date of fire accident was Rs.1,80,000.

Mr. A received the following amounts from the insurance company:

(i) Towards loss of stock	Rs.4,80,000
(ii) Towards damage of machinery	Rs.6,00,000
(iii) Towards gold chain and diamond ring	Rs.1,80,000

You are requested to briefly comment on the tax treatment of the above three items under the provisions of the Income-tax Act, 1961.

Answer

(i) Compensation towards loss of stock

Any compensation received from the insurance company towards loss/damage to stock in trade is to be construed as a trading receipt. Hence, Rs.4,80,000 received as insurance claim for loss of stock has to be assessed under the head "Profit and gains of business or profession".

Note - The assessee can claim the value of stock destroyed by fire as revenue loss, eligible for deduction while computing income under the head "Profits and gains of business or profession".

(ii) Compensation towards damage to machinery

The question does not mention whether the salvaged machinery is taken over by the Insurance company or whether there was any replacement of machinery during the year. Assuming that the salvaged machinery is taken over by the Insurance

company, and there was no fresh addition of machinery during the year, the block of machinery will cease to exist. Therefore, Rs.4,80,000 being the excess of written down value (i.e. Rs.10,80,000) over the insurance compensation (i.e. Rs.6,00,000) will be assessable as a short-term capital loss.

Note – If new machinery is purchased in the next year, it will constitute the new block of machinery, on which depreciation can be claimed for that year.

(iii) Compensation towards loss of gold chain and diamond ring

Gold chain and diamond ring are capital assets as envisaged by section 2(14). They are not “personal effects”, which alone are to be excluded. As per section 45(1A), if any profit or gain arises in a previous year owing to receipt of insurance claim, the same shall be chargeable to tax as capital gains. The capital gains has to be computed by reducing the indexed cost of acquisition of jewellery from the insurance compensation of Rs.1,80,000.

Question 12

Mr. A who transfers land and building on 2.01.2011, furnishes the following information:

- (i) Net consideration received Rs.10 lakhs.*
- (ii) Value adopted by stamp valuation authority, which was not contested by Mr.A Rs.15 lakhs.*
- (iii) Value ascertained by Valuation Officer on reference by the Assessing Officer Rs.16 lakhs.*
- (iv) This land was distributed to Mr. A on the partial partition of his HUF on 1.4.1981. Fair market value of the land as on 1.4.81 was Rs.1,10,000.*
- (v) A residential building was constructed on the above land by Mr. A at a cost of Rs.3,20,000 (construction completed on 1.12.2002) during the financial year 2002-2003.*
- (vi) Brought forward short-term capital loss (incurred on sale of shares during the financial year 2007-2008) Rs.2,05,000.*

Mr. A seeks your advice as to the amount to be invested in NHA/RECL bonds so as to be exempt from clutches of capital gain tax. Cost inflation indices for the financial years 1981-82, 2002-03 & 2010-11 are 100, 447 and 711 respectively.

Answer

Computation of Capital Gains of Mr. A for the Assessment Year 2011-12.

Particulars	Rs.	Rs.
Full value of consideration (deemed)		15,00,000
(Indexation benefit is available since land and buildings are long-		

Taxation

term capital assets).

Less: Indexed cost of land $(1,10,000 \times 711/100)$	7,82,100	
Indexed cost of building $(3,20,000 \times 711/447)$	5,08,993	12,91,093
Long-term capital gain		2,08,907
Less: Brought forward short-term capital loss set off		2,05,000
Amount to be invested in NHAI / RECL bonds		3,907

Notes :

- (i) Where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed by any authority of a State Government (Stamp Valuation Authority) for the purpose of payment of stamp duty in respect of such asset and the same is not contested by the assessee, such value adopted or assessed shall be deemed to be the full value of the consideration received or accruing as a result of such transfer. [Section 50C(1)]. Accordingly, full value of consideration will be Rs.15 lakhs in this case.
- (ii) It is further provided in section 50C(3) that where the valuation is referred by the Assessing Officer to Valuation Officer and the value ascertained by such Valuation Officer exceeds the value adopted or assessed by the stamp valuation authority, the value adopted or assessed by the stamp valuation authority shall be taken as the full value of the consideration received or accruing as a result of the transfer. Since the value ascertained by the valuation officer (i.e. Rs.16 lakhs) is higher than the value adopted by the stamp valuation authority (i.e. Rs.15 lakhs), the full value of consideration in this case is Rs.15 lakhs.
- (iii) Cost of land which is acquired on partition of HUF is the cost to the previous owner. Since date and cost of acquisition to the previous owner are not given, fair market value as on 1.4.1981 is taken as the cost and indexed.
- (iv) Brought forward unabsorbed short term capital loss can be set off against any capital gains, short term or long term, for 8 assessment years immediately succeeding the assessment year for which the loss was first computed. It is assumed that the short-term capital loss relating to the financial year 2007-08 is unabsorbed.
- (v) As per section 54EC, an assessee can avail exemption in respect of long-term capital gains, if such capital gains are invested in the bonds issued by the NHAI / RECL redeemable after 3 years. Such investment is required to be made within a period of 6 months from the date of transfer of the asset. The exemption shall be the amount of capital gain or the amount of such investment made, whichever is less.

Question 13

X is in possession of agricultural land situated within urban limits, which is used for agricultural purposes during the preceeding 3 years by his father. On 4.4.2010, this land is compulsorily acquired by the Government of India on a compensation fixed and paid by it for Rs.10 lakhs. Advise X as to the tax consequences, assuming that the entire amount is invested in purchase of shares.

Answer

Section 10(37) exempts the capital gains arising to an individual or a Hindu Undivided Family from transfer of agricultural land by way of compulsory acquisition, or a transfer, the consideration for which is determined or approved by the RBI or the Central Government.

Such exemption is available where the compensation or the enhanced compensation or consideration, as the case may be, is received on or after 1st April, 2004 and the land has been used for agricultural purposes during the preceding two years by such individual or a parent of his or by such Hindu undivided family.

Since all the above conditions are fulfilled in this case, X is entitled to exemption under section 10(37) of the entire capital gains arising on sale of agricultural land.

Question 14

Briefly discuss about the provisions relating to claiming of exemption in respect of short-term capital gains, in order to reduce tax liability.

Answer

Deduction under sections 54B, 54D, 54G and 54GA can be claimed in respect of income from short term capital gains in order to reduce tax liability.

- (i) Under section 54B, if an individual transfers his agricultural land which has been used by him or his parents for agricultural purposes for a period of two years immediately preceding the date of transfer and he purchases another agricultural land within a period of two years from the date of such transfer, the amount of capital gain or the actual amount invested in purchasing the new agricultural land whichever is lower, is allowed as exemption.
- (ii) Under section 54D, deduction is allowable to any assessee, being an industrial undertaking on compulsory acquisition of land and building forming part of the industrial undertaking. Such land and building should have been used for the purpose of the business of the undertaking for at least two years immediately preceding the date of compulsory acquisition and another land or building should be purchased or constructed within a period of three years for the use of existing or newly set-up industrial undertaking. In such a case, the capital gain or the amount invested in the new land and building, whichever is lower, would go to reduce income from short term capital gains.

Taxation

- (iii) Section 54G exempts capital gain on transfer of assets, being machinery, plant, building or land, used for the business of an industrial undertaking situated in an urban area consequent to shifting of such industrial undertaking to any area other than an urban area. The assessee, being an industrial undertaking, should, within a period of one year before or three years after the date of transfer, purchase machinery, plant or acquire building or land or construct building and complete shifting to the new area. In such a case, the short term capital gain would be reduced to the extent of the cost of the new assets and expenses incurred for shifting the industrial undertaking.
- (iv) Section 54GA exempts capital gain on transfer of capital asset, being machinery, plant, building, and or any rights in building or land used for the purposes of the business of an industrial undertaking situated in an urban area, effected in course of, or in consequence of the shifting of such industrial undertaking to any special economic zone whether developed in any urban area or any other area.

Question 15

Mr. Y submits the following information pertaining to the year ended 31st March, 2011.

- (i) *On 30.11.2010, when he attained the age of 60, his friends in India gave a flat at Surat as a gift, each contributing a sum of Rs.20,000 in cash. The cost of the flat purchased using the various gifts was Rs.3.40 lacs.*
- (ii) *His close friend abroad sent him a cash gift of Rs.75,000 through his relative for the above occasion.*
- (iii) *Mr. Y sold the above flat on 30.1.2011 for Rs.3.6 lacs. The Registrar's valuation for stamp duty purposes was Rs.3.7 lacs. Neither Mr. Y nor the buyer, questioned the value fixed by the Registrar.*
- (iv) *He had purchased some equity shares in X Pvt. Ltd., on 5.2.2006 for Rs.3.5 lacs. These shares were sold on 15.3.2011 for Rs.2.8 lacs.*

You are requested to calculate the total income of Mr. Y for the assessment year 2011-12.

[Cost Inflation Index for F.Y. 2005-06 – 497, F.Y. 2009-10 – 632, 2010-11: 711]

Answer

Computation of total income of Mr.Y for A.Y. 2011-12

Particulars	Rs.	Rs.	Rs.
Capital Gains			
Short term capital gains (on sale of flat)			
(i) Sale consideration	3,60,000		
(ii) Stamp duty valuation	3,70,000		

Capital Gains

Consideration for the purpose of capital gains as per section 50C (stamp duty value, since it is higher than sale consideration)	3,70,000	
Less: Cost of acquisition [As per section 49(4), cost to be taken into consideration for 56(2)(viii) will be the cost of acquisition]	3,40,000	
		30,000
Long term capital loss on sale of equity shares of X Pvt. Ltd		
Sale consideration	2,80,000	
Less: Indexed cost of acquisition (3,50,000 × 711/497)	5,00,704	
Long term capital loss to be carried forward	2,20,704	
(See Note 1 below)		
Income from other sources:		
Gift from friends by way of immovable property on 30.11.2010 [See Note 3 below].	3,40,000	
Gift received from a close friend (unrelated person) [See Note 2 below]	75,000	
Total income	4,45,000	

Notes:

1. In the given problem, shares have been held for more than 12 months hence, constitute a long term capital asset. The loss arising from sale of such shares, is therefore a long-term capital loss. As per section 70(3), long term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss cannot be set-off against short-term capital gains. However, such long-term capital loss can be carried forward to the next year for set-off against long-term capital gains arising in that year.
2. Any sum received from an unrelated person will be deemed as income and taxed as income from other sources if the aggregate sum received exceeds Rs. 50,000 in a year [Section 56(2)(vii)].
3. Receipt of immovable property without consideration would attract the provisions of [Section 56(2)(vii)] .

Question 16

Bala sold his vacant site on 21.09.2010 for Rs.7,00,000. It was acquired by him on 01.10.1994 for Rs.1,50,000.

Taxation

The State stamp valuation authority fixed the value of the site at the time of transfer @ Rs.13,00,000.

Compute capital gains in the hands of Bala and give your reasons for computation.

Cost inflation index : (1994-95 = 259 and 2010-11 = 711)

Answer

Computation of capital gains of Shri Bala for the A.Y.2011-12

	Rs.
Deemed sale consideration as per section 50B	13,00,000
Less : Indexed cost of acquisition $(1,50,000 \times 711 / 259)$	4,11,776
Taxable long term capital gain	8,88,224

Note: According to section 50C(1), where the consideration received or accruing as a result of the transfer of land or building or both is less than the value adopted or assessed or assessable by the State Stamp Valuation Authority for the purpose of payment of stamp duty in respect of such transfer, then the value so adopted or assessed or assessable by the State Stamp Valuation Authority shall be deemed to be the full value of the consideration received or accruing as a result of the transfer.

In this case, since the consideration of Rs.7,00,000 received on transfer of land is less than the value of Rs.13,00,000 fixed by the State Stamp Valuation Authority, the value adopted by the State Stamp Valuation Authority is deemed to be the full value of consideration and capital gains is calculated accordingly.

Question 17

Mr. 'X' furnishes the following data for the previous year ending 31.3.2011.

- (a) Unlisted Equity Shares of AB Ltd., 10,000 in number were sold on 31.5.2010, at Rs.350 for each share.*
- (b) The above shares of 10,000 were acquired by 'X' in the following manner:*
 - (i) Received as gift from his father on 1.6.1980 (5,000 shares) the market price on 1.4.81 Rs.50 per share.*
 - (ii) Bonus shares received from AB Ltd. on 21.7.1984 (2,000 shares).*
 - (iii) Purchased on 1.2.1993 at the price of Rs.125 per share (3,000 shares).*
- (c) Purchased one residential house at Rs.25 lakhs, on 1.5.2011 from the sale proceeds of shares.*
- (d) 'X' is already owning a residential house, even before the purchase of above house.*

You are required to compute the taxable capital gain. He has no other source of income chargeable to tax.

(Cost Inflation Index – Financial year 1992-93: 223; Financial year 2010-2011 : 711)

Answer

Computation of taxable capital gain of Mr. 'X' for A.Y. 2011-12

Particulars	Rs.	Rs.
Sale consideration received on sale of 10,000 shares @ Rs.350 each		35,00,000
Less: Indexed cost of acquisition		
(a) 5,000 shares received as gift from father on 1.6.1980 Indexed cost $5000 \times 50 \times 711 / 100$	17,77,500	
(b) 2,000 bonus shares received from AB Ltd Bonus shares are acquired on 21.7.84 (i.e after the year 1980 when the original shares were purchased). Hence, the cost is Nil.	Nil	
(c) 3000 shares purchased on 1.2.1993 @ Rs.125 per share. The indexed cost is $3000 \times 125 \times 711 / 223$	11,95,628	29,73,128
Long term capital gain		5,26,872
Less : Exemption under section 54F (See Note below) $5,26,872 \times 25,00,000 / 35,00,000$		3,76,337
Taxable long term capital gain		1,50,535

Note:

Exemption under section 54F can be availed by the assessee subject to fulfillment of the following conditions :

- (a) The assessee should not own more than one residential house on the date of transfer of the long-term capital asset;
- (b) The assessee should purchase a residential house within a period of 1 year before or 2 years after the date of transfer or construct a residential house within a period of 3 years from the date of transfer of the long-term capital asset.

In this case, the assessee has fulfilled the two conditions mentioned above. Therefore, he is entitled to exemption under section 54F.

Taxation

Question 18

What are the transactions not regarded as transfer as per section 47 of the Income-tax Act, 1961?

Answer

Refer page 4.207 of Study Material.

Question 19

Ms. Vimla sold a residential building at Jodhpur for Rs.15,00,000 on 01-07-10.

The building was acquired for Rs.1,50,000 on 01-06-96.

She paid brokerage @ 2% at the time of sale of the building. She invested Rs.7 lakhs in purchase of a residential building in December 2010 and deposited Rs.2 lakhs in NHA Capital Gains Bond in March, 2011.

Compute her taxable capital gain.

Cost inflation index

1996-97 - 305

2010-11 - 711

Answer

Computation of taxable capital gain of Ms. Vimla for A.Y.2011-12

Particulars	Rs.	Rs.
Sale price of residential building	15,00,000	
Less : Brokerage @ 2%	<u>30,000</u>	
Net consideration		14,70,000
Less :Indexed cost of acquisition		
1,50,000 x 711 / 305		<u>3,49,672</u>
		11,20,328
Less: Deduction u/s.54 for purchase of new residential house in December 2010		<u>7,00,000</u>
Taxable long term capital gain		4,20,328

Note : One of the conditions for claiming deduction u/s 54EC for the investment in RECL/NHA Capital Gains bonds is that the deposit should be made within 6 months from the date of transfer. In this case, the transfer took place on 1.7.10 and the 6 months period within which the deposit should be made for the purpose of section 54EC would expire by 1.1.11. The

investment in REC/NHAI Capital Gains bonds was made only in March 2011. Therefore, the assessee is not eligible for section 54EC deduction.

Question 20

Mrs. Malini Hari shifted her industrial undertaking located in corporation limits of Faridabad, to a Special Economic Zone (SEZ) on 1.12.2010 :

<i>The following particulars are available:</i>	<i>Rs.</i>
(a) Land: Purchased on 20.01.2002	4,26,000
Sold for	22,00,000
(b) Building [Construction completed on 14.03.2004]	
WDV of building as on 01.04.2010	8,20,000
Sold for	11,39,000
(c) WDV of cars as on 01.04.2010	7,40,000
Sold for	6,00,000
(d) Expenses on shifting the undertaking	1,15,000
(e) Assets acquired for the undertaking in the SEZ (on or before 25.06.2011):	
(i) Land	3,00,000
(ii) Building	5,00,000
(iii) Computers	1,00,000
(iv) Car	4,20,000
(v) Machinery (Second hand)	2,00,000
(vi) Furniture	50,000

There is no intention of investing in any other asset in this undertaking.

Compute the exemption available under section 54GA for the assessment year 2011-12.

Cost inflation indices are:

<i>Financial year</i>	<i>Index</i>
2001-02	426
2010-11	711

Answer

Where an assessee shifts an existing undertaking from an urban area to a SEZ and incurs expenses for shifting and acquires new assets for the undertaking in the SEZ, exemption under section 54GA would be available in such a case.

Taxation

The capital gain, short-term or long-term, arising from transfer of land, building, plant and machinery in the existing undertaking would be exempt under section 54GA if the assessee, within a period of one year before or three years after the date on which the transfer took place,

- (i) acquires plant and machinery for use in the undertaking in the SEZ;
- (ii) acquires land or building or constructs building for the business of the undertaking in the SEZ;
- (iii) incurs expenses on shifting of the undertaking.

Computation of capital gain :

(a) <i>Land:</i>	
Sale price	22,00,000
Less: Indexed cost of acquisition $4,26,000 \times 711/426$	<u>7,11,000</u>
Long-term capital gain	<u>14,89,000</u>
(b) <i>Building:</i>	
Sale value	11,39,000
Less: Opening WDV	<u>8,20,000</u>
Short-term capital gain under section 50	<u>3,19,000</u>
(c) <i>Plant:</i>	
Car	
Sale value	6,00,000
Less: Opening WDV	<u>7,40,000</u>
Short term capital loss under section 50	<u>(-)1,40,000</u>
Net short term capital gain (Rs. 3,19,000 – Rs.1,40,000)	1,79,000
Total capital gain (LTCG+STCG)	
i.e. Rs. 14,89,000+ Rs.1,79,000	16,68,000

Exemption under section 54GA is available in respect of the following assets acquired and expenses incurred:

	Rs.
Land	3,00,000
Building	5,00,000
Plant:	
Computers	1,00,000
Car	4,20,000
Machinery	2,00,000
Expenses of shifting	<u>1,15,000</u>
Total Exemption	<u>16,35,000</u>

Note:

1. The total exemption available under section 54GA is the lower of capital gains of Rs. 16,68,000 or the amount of investment which is Rs.16,35,000. Hence, the amount of exemption available under section 54GA is Rs.16,35,000. The taxable capital gains would be Rs. 33,000 (Rs. 16,68,000 – Rs. 16,35,000).
2. Furniture purchased is not eligible for exemption under section 54GA.
3. There is no restriction regarding purchase of second hand machinery.
4. Computers and car would constitute Plant.

Question 21

Mr. Thomas inherited a house in Jaipur under will of his father in May, 2002. The house was purchased by his father in January, 1980 for Rs.2,50,000. He invested an amount of Rs.7,00,000 in construction of one more floor in this house in June, 2004. The house was sold by him in November, 2010 for Rs.37,50,000. The valuation adopted by the registration authorities for charge of stamp duty was Rs.47,25,000 which was not contested by the buyer, but as per assessee's request, the Assessing officer made a reference to Valuation officer. The value determined by the Valuation officer was Rs.47,50,000. Brokerage @ 1% of sale consideration was paid by Mr. Thomas to Mr. Sunil. The market value of house as on 01.04.1981 was Rs.2,70,000.

You are required to compute the amount of capital gain chargeable to tax for A.Y. 2011-12 with the help of given information and by taking CII for the F.Y. 2002-03 : 447, F.Y. 2010-11 as 711 and for F.Y. 2004-05 as 480.

Answer

Computation of Long term Capital Gain for A.Y. 2011-12

Sale consideration as per section 50C of the Act			47,25,000
(Note-1)			
Less: Expenses incurred on transfer being brokerage			
@ 1% of sale consideration of Rs. 37.50 lacs			<u>37,500</u>
			46,87,500
Less: Indexed cost of acquisition (Note-2)			
	$\frac{2,70,000 \times 711}{447}$	= 4,29,463	
	447		
Indexed cost of improvement			
	$\frac{7,00,000 \times 711}{480}$	= 10,36,875	<u>14,66,338</u>
	480		
Long term capital gain			<u>32,21,162</u>

Taxation

Notes:

1. As per section 50C, where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the valuation by the stamp valuation authority, such value adopted or assessed by the stamp valuation authority shall be deemed to be the full value of consideration. Where a reference is made to the valuation officer, and the value ascertained by the valuation officer exceeds the value adopted by the stamp valuation authority, the value adopted by the stamp valuation authority shall be taken as the full value of consideration.

Sale consideration	Rs. 37,50,000
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Valuation made by registration authority for stamp duty	Rs. 47,25,000
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Valuation made by the valuation officer on a reference	Rs. 47,50,000
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Applying the provisions of section 50C to the present case, Rs. 47,25,000, being, the value adopted by the registration authority for stamp duty, shall be taken as the sale consideration for the purpose of charge of capital gain.

2. The house was inherited by Mr. Thomas under the will of his father and therefore the cost incurred by the previous owner shall be taken as the cost. Value as on 01.04.81 accordingly shall be adopted as the cost of acquisition of the house property. However, indexation benefit will be given from the year in which Mr. Thomas first held the asset i.e. P.Y.2002-03.

Question 22

Ms. Vasudha contends that sale of a work of art held by her is not exigible to capital gains tax. Is she correct?

Answer

As per section 2(14)(ii), the term "personal effect" excludes any work of art. As a result, any work of art will be considered as a capital asset and sale of the same will attract capital gains tax. Thus, the contention of Ms. Vasudha is not correct.

Question 23

Ms. Vasumathi purchased 10,000 equity shares of ABC Co. Pvt. Ltd. on 28.2.2004 for Rs. 1,20,000. The company was wound up on 31.7.2010. The following is the summarized financial position of the company as on 31.7.2010:

Liabilities	Rs.	Assets	Rs.
60,000 Equity shares	6,00,000	Agricultural lands	42,00,000
General reserve	40,00,000	Cash at bank	6,50,000

Capital Gains

Provision for taxation	2,50,000	
	<u>48,50,000</u>	<u>48,50,000</u>

The tax liability (towards dividend distribution tax) was ascertained at Rs. 3,00,000, after considering refund due to the company. The remaining assets were distributed to the shareholders in the proportion of their shareholding. The market value of 6 acres of agricultural land (in an urban area) as on 31.7.2010 is Rs. 10,00,000 per acre.

The agricultural land received above was sold by Ms. Vasumathi on 28.2.2011 for Rs.15,00,000.

Discuss the tax consequences in the hands of the company and Ms. Vasumathi.

Cost inflation indices are:

Financial year	Cost Inflation index
2003-04	463
2010-11	711

Answer

In the hands of the company :

As per section 46(1), distribution of capital assets amongst the shareholders on liquidation of the company is not regarded as "transfer" in the hands of the company. Consequently, there will be no capital gains in the hands of the company.

In the hands of Ms. Vasumathi (shareholder)

Section 46(2) provides that such capital gains would be chargeable in the hands of the shareholder.

Particulars	Amount (Rs.)
Ms. Vasumathi holds 1/6 th of the shareholding of the company	
Market value of agricultural land received (1acre @ Rs.10 Lakhs)	10,00,000
Cash at bank [1/6 th of (Rs. 6,50,000 – Rs. 3,00,000)]	58,333
	<u>10,58,333</u>
Less: Deemed dividend under section 2(22)(c) - 1/6 th of (Rs.40,00,000- Rs.50,000)	6,58,333
	<u>4,00,000</u>
Consideration for computing Capital Gain	1,84,276
Less: Indexed cost of acquisition of Shares (Rs. 1,20,000 x 711/ 463)	<u>1,84,276</u>
Long term capital gains	<u>2,15,724</u>

Taxation

Notes:

1. Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to capital gains in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution. Hence, the short-term capital gains in the hands of Ms. Vasumathi (shareholder) at the time of sale of urban agricultural land should be computed as follows:

Particulars	Rs.
Sale consideration	15,00,000
Less : Fair market value of the agricultural land on the date of distribution	10,00,000
Short term capital gain	5,00,000

2. Dividend under section 2(22)(c) amounting to Rs.6,58,333 will be exempt under section 10(34).
3. Since the question states that there is refund due to the company, it is assumed that the provision for taxation of Rs. 2,50,000 shown in Balance Sheet is in respect of dividend distribution tax. Therefore, the tax liability in respect of dividend distribution tax ascertained at Rs. 3,00,000 has to be reduced from bank balance while computing full value of consideration under section 46(2). Rs. 50,000, being the difference between Rs. 3,00,000 and Rs. 2,50,000, has to be reduced from General Reserve for calculating deemed dividend under section 2(22)(c).

Question 24

State with reasons whether the following statements are true or false having regard to the provisions of the Income-tax Act, 1961:

- (a) *Capital gain of Rs.75 lakh arising from transfer of long term capital assets on 1.5.2010 will be exempt from tax if such capital gain is invested in the bonds redeemable after three years, issued by NHAI under section 54EC of the Act.*
- (b) *As per section 49(2A), read with section 47(xa) of the Income-tax Act, 1961, no capital gains would arise on conversion of foreign currency exchangeable bonds into shares or debentures, for facilitating the issue of FCEBs by companies.*

Answer

(a) False

The exemption under section 54EC has been restricted, by limiting the maximum investment in long term specified assets (i.e. bonds of NHAI or RECL, redeemable after 3 years) to Rs.50 lakh during any financial year. Therefore, in this case, the exemption under section 54EC can

be availed only to the extent of Rs.50 lakh, provided the investment is made before 1.11.2010 (i.e., within six months from the date of transfer).

(b) True

As per section 47(xa), any transfer by way of conversion of bonds referred to in section 115AC into shares and debentures of any company is not regarded as transfer. Therefore, there will be no capital gains on conversion of foreign currency exchangeable bonds into shares or debentures.

Question 25

Mrs. X, an individual resident woman, wanted to know whether income-tax is attracted on sale of gold and jewellery gifted to her by her parents on the occasion of her marriage in the year 1979 which was purchased at a total cost of Rs.2,00,000?

Answer

The definition of capital asset under section 2(14) includes jewellery. Therefore, capital gains is attracted on sale of jewellery, since jewellery is excluded from personal effects. The cost to the previous owner or the fair market value as on 1/4/1981, whichever is more beneficial to the assessee, would be treated as the cost of acquisition. Accordingly, in this case, long term capital gain @ 20% will be attracted in the year in which the gold and jewellery is sold by Mrs.X.

Question 26

Mr. Kumar is the owner of a residential house which was purchased in September, 1992 for Rs. 5,00,000. He sold the said house on 5th August, 2010 for Rs. 24,00,000. Valuation as per stamp valuation authority of the said residential house was Rs. 35,00,000. He invested Rs. 8,00,000 in NHAI Bonds on 12th January, 2011. He purchased a residential house on 5th July, 2011 for Rs. 12,00,000. He gives other particulars as follows:

<i>Interest on Bank Deposit</i>	<i>Rs. 32,000</i>
<i>Investment in public provident fund</i>	<i>Rs. 30,000</i>

You are requested to calculate the taxable income for the assessment year 2011-12 and the tax liability, if any.

Cost inflation index for F.Y. 1992-93 and 2010-11 are 223 and 711, respectively.

Taxation

Answer

Computation of total income and tax liability of Mr. Kumar for the A.Y.2011-12

Particulars	Rs.	Rs.
Capital Gains:		
Sale price of the residential house	24,00,000	
Valuation as per Stamp Valuation authority	35,00,000	
(Value to be taken is the higher of actual sale price or valuation adopted for stamp duty purpose as per section 50C)		
Therefore, Consideration for the purpose of Capital Gains	35,00,000	
Less: Indexed Cost of Acquisition = $5,00,000 \times 711 / 223$	15,94,170	
Long-term Capital Gain		19,05,830
Income from other sources:		
Interest on bank deposits		32,000
Gross Total Income		19,37,830
Less: Deduction under Chapter VI-A		
Section 80C – Investment in PPF		30,000
Total Income		19,07,830
Tax liability		
Tax @ 20% on Rs. 17,47,830, being (Rs.19,07,830 – Rs. 1,60,000)		3,49,566
Add: Education Cess @ 2%		6,991
Secondary and Higher Education Cess @ 1%		3,496
		3,60,053

Note:

The unexhausted basic exemption limit (i.e. Rs. 1,58,000) can be adjusted against long term capital gains and the balance long term capital gains of Rs. 17,47,830 is taxable @ 20% plus education cess @ 2% and secondary and higher education cess @ 1%.

Question 27

Mr. Abhik's father, who is a senior citizen, had pledged his residential house to a bank under a notified reverse mortgage scheme. He was getting loan from bank in monthly installments. Mr. Abhik's father did not repay the loan on maturity and gave possession of the house to the bank to discharge his loan. How will the treatment of long-term capital gain be made on such reverse mortgage transaction?

Answer

Section 47(xvi) provides that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government shall not be considered as a transfer for the purpose of capital gain.

Accordingly, the transaction made by Mr. Abhik's father will not be regarded as a transfer. Therefore, no capital gain will be charged on such transaction.

Further, section 10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in installment, in a transaction of reverse mortgage would be exempt from income-tax.

However, capital gains tax liability would be attracted at the stage of alienation of the mortgaged property by the bank for the purposes of recovering the loan.

Question 28

Mr. Pranav, a resident individual had purchased a plot of land at a cost of Rs.75,000 in June, 1998. He constructed a house for his residence on that land at a cost of Rs.1,25,000 in August, 2000. He sold that house in May, 2010 at Rs.15,00,000 and purchased another residential house in June, 2010 for Rs.8,00,000. He furnishes other income and investment as follows :

	Rs.
<i>Interest on fixed deposit with a bank (Net of TDS Rs. 5,000)</i>	45,000
<i>Investment in PPF</i>	20,000
<i>Cost inflation index for financial year 1998-99, 2000-01 and 2010-11 are 351, 406 and 711 respectively</i>	
<i>You are required to compute taxable income and tax payable by Mr. Pranav for the assessment year 2011-12</i>	

Answer

Computation of taxable income and tax payable by Mr. Pranav for the A.Y. 2011 -12

	Rs.	Rs.
1. Income from Capital Gains		
Full value of consideration		15,00,000
Less : Indexed cost of acquisition of land		
$\frac{\text{Rs.75,000} \times 711}{351}$		1,51,923
		13,48,077

Taxation

<i>Less : Indexed cost of construction of house</i>		
$\frac{\text{Rs.1,25,000} \times 711}{406}$		2,18,904
		<u>11,29,173</u>
<i>Less : Deduction under section 54</i>		
Cost of new residential house		8,00,000
Long term capital gains		3,29,173
2. Income from other sources		
Interest on Bank deposit (Net)	45,000	
<i>Add : Tax deducted at source</i>	5,000	50,000
Gross total income		3,79,173
<i>Less: Deduction under Chapter VIA :</i>		
<i>Deduction under section 80C</i>		
Investment in PPF		20,000
Taxable income		3,59,173
Taxable income (rounded off)		3,59,170
Components of Total income		
<i>Special income</i>		
Long-term Capital gains	3,29,170	
Normal Income	30,000	
	<u>3,59,170</u>	
Tax on normal income of Rs.30,000 [Rs. 50,000 – Rs. 20,000]		Nil
<i>Tax on LTCG</i>		
LTCG (Maximum amount not chargeable to tax - Normal Income) @ 20%		39,834
u/s.112 = {Rs. 3,29,170 – (1,60,000 – 30,000)} x 20%		
		39,834
<i>Add : Education cess @ 2%</i>		797
<i>Secondary and higher education cess @ 1%</i>		398
Tax payable		41,029
<i>Less: Tax deducted at source</i>		5,000
		<u>36,029</u>
Tax payable (rounded off)		36,030

UNIT 5 : INCOME FROM OTHER SOURCES

Question 1

Choose the correct answer with reference to the provisions of the Income-tax Act, 1961.

- (i) *Rakesh received Rs.70,000 from his friend on the occasion of his birthday.*
 - (a) *The entire amount of Rs.70,000 is taxable*
 - (b) *Rs.20,000 is taxable*
 - (c) *The entire amount is exempt*
 - (d) *None of the above.*
- (ii) *Family pension received by a widow of a member of the armed forces where the death of the member has occurred in the course of the operational duties in the circumstances and subject to prescribed conditions, is*
 - (a) *Exempt upto Rs.3,00,000*
 - (b) *Exempt upto Rs.3,50,000*
 - (c) *Totally exempt under section 10(19)*
 - (d) *Totally chargeable to tax*
- (iii) *Gift of Rs.5,00,000 received on 10th July, 2010 through account payee cheque from a non-relative regularly assessed to income-tax, is*
 - (a) *A capital receipt not chargeable to tax*
 - (b) *Chargeable to tax as income from other sources*
 - (c) *Chargeable to tax as business income*
 - (d) *Exempt upto Rs.50,000 and balance chargeable to tax as income from other sources.*

Answer

- (i) (a) The entire amount of Rs.70,000 is taxable.
- (ii) (c) totally exempt under section 10(19)
- (iii) (b) Chargeable to tax as income from other sources

Question 2

State whether True/False with proper reasons of the following statements with regard to provisions of Income-tax Act, 1961:

Taxation

“A” receives Rs.2 lakh from his friends on the occasion of his marriage on 22.12.10 and Rs.1 lakh from the brother of his father-in-law on 31.12.10. A’s income includible under “other sources” for the previous year 2010-11 would be Rs.3 lakh.

Answer

False

Where any sum of money is received without consideration by an individual or a Hindu undivided family from any person or persons and the aggregate value of all such sums received during the previous year exceeds Rs.50,000/-, the whole of the aggregate value of such sum shall be included in the total income of such individual or Hindu undivided family under the head “Income from other sources”.

However, in order to avoid hardship in genuine cases, certain sums of money received have been exempted, which includes, *inter-alia*, any sum received on the occasion of the marriage of the individual and any sum received from any relative. As such, Rs.2 lakh received from friends on the occasion of marriage is exempt. However, brother of father-in-law is not included in the definition of relative. Hence, Rs.1 lakh is taxable under the head “Income from other sources”.

The statement that Rs.3 lakh is includible in A’s income is, therefore, false.

Question 3

Check the taxability of the following gifts received by Mrs. Rashmi during the previous year 2010-11 and compute the taxable income from gifts for Assessment Year 2011-12:

- (i) On the occasion of her marriage on 14.8.10, she has received Rs.90,000 as gift out of which Rs.70,000 are from relatives and balance from friends.*
- (ii) On 12.9.10, she has received gift of Rs.18,000 from cousin of her mother.*
- (iii) A cell phone worth Rs.21,000 is gifted by her friend on 15.8.2010.*
- (iv) She gets a cash gift of Rs.25,000 from the elder brother of her husband’s grandfather on 25.10.2010.*
- (v) She has received a cash gift of Rs.12,000 from her friend on 14.4.2010.*

Answer

Computation of taxable income of Mrs. Rashmi from gifts for A.Y.2011-12

Sl. No.	Particulars	Taxable amount Rs.	Reason for taxability or otherwise of each gift
1.	Relatives and friends	Nil	Gifts received on the occasion of marriage are not taxable.

2.	Cousin of Mrs. Rashmi's mother	18,000	Cousin of Mrs. Rashmi's mother is not a relative. Hence, the cash gift is taxable.
3.	Friend	-	Cell phone is not included in the definition of property. Hence, it is not taxable.
4.	Elder brother of husband's grandfather	25,000	Brother of husband's grandfather is not a relative. Hence, the cash gift is taxable.
5.	Friend	12,000	Cash gift from friend is taxable.
Aggregate value of gifts		55,000	

Since the sum of money received by Mrs. Rashmi without consideration during the previous year 2010-11 exceeds Rs.50,000, the whole of the amount is chargeable to tax under section 56(2)(vii) of the Income-tax Act, 1961.

Question 4

What are the deductions allowable under section 57 of the Income-tax Act, 1961 in respect of "Income from other sources"?

Answer

See page 4.262 of Study Material.

Question 5

When would the dividend income be taxed in the hands of a shareholder?

Answer

The provisions relating to the year of taxability of dividend are contained in section 8 of the Income-tax Act, 1961.

- (a) Any dividend declared by a company or distributed or paid by it within the meaning of section 2(22) of the Act shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be.
- (b) Any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the member who is entitled to it.

Students may note that any dividend which is liable for dividend distribution tax covered by section 115-O (being a dividend declared by a domestic company) is exempt under section 10(34) and hence would not be chargeable to tax.

Question 6

How is “dividend stripping” enforced by section 94(7) of the Income-tax Act, 1961?

Answer

According to section 94(7), where :

- (a) any person buys or acquires any securities or units within a period of three months prior to the record date ; and
- (b) such person sells or transfers such securities within a period of three months after such record date or transfers such units within a period of nine months after such record date ; and
- (c) the dividend or income on such securities or units received or receivable by such person is exempt from tax.

then, the loss, if any, arising to him on account of such purchase and sale of securities or units, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or units, has to be ignored for the purposes of computing his income chargeable to tax.