

INCOME FROM OTHER SOURCES

Question No.1. A Company, incorporated for the manufacture of steel, had not commenced production. The plant and machinery was in the stage of erection. During the previous year ending 31.3.2009, it paid interest on borrowings, amounting to Rs.20 Lakhs. It also received interest of Rs. 1.50 Lakhs on investment in Short-Term deposits of moneys not immediately required for business. The Assessing Officer assessed the interest income under other sources. Discuss the correctness of the assessment.

- a) Interest on surplus funds: Interest income earned on deposits made out of surplus funds before commencement of business is taxable as "Income from other sources".
- b) In view of the above judgement, the sum received as interest on deposits shall be charged to tax under the head 'Income from Other Sources'.
- c) No part of the interest paid on the loan borrowed shall be allowed as deduction u/s 57 as the same was not borrowed wholly and exclusively for the purpose of earning such interest. Whole of such interest shall be capitalised.
- d) Therefore, the action of the Assessing Officer is correct.

Question No.2. A Chartered Accountant handles the moneys belonging to his clients and maintains a separate account for these moneys. Part of these moneys, in excess of current requirements, is kept in deposit on which interest is earned. The Assessing Officer proposes to assess the interest income in the hands of the Chartered Accountant. How would you contest the action of the Assessing Officer?

- a) Under the Chartered Accountants Act, 1949, a Chartered Accountant has to keep the monies belonging to a client in a separate bank account. He holds these funds only in a fiduciary capacity. Therefore, the Chartered Accountant cannot make use of such monies for his own benefit.
- b) The beneficial interest in the monies so deposited in a separate bank account lies with the owner of the funds, i.e. the clients. Therefore, the interest accrued on such funds also belongs to the clients.
- c) In view of the above, the interest does not accrue in the hands of the Chartered Accountant and hence not chargeable to tax in his hands.
- d) Therefore, action of the Assessing Officer is not correct.

Question No.3. Discuss the correctness or otherwise of the following proposition: Kumar took part in a motor-car rally and is awarded a prize money of Rs. 10,000 for winning a race. He claims that the amount of Rs. 10, 000 is exempt from tax.

- a) Winnings from motorcar rally are a return for skill and endurance. It is taxable as income.
- b) In view of the above Supreme Court ruling, the amount of Rs.10,000 won by Mr. Kumar shall be treated as income and chargeable to tax under the head Income from Other Sources.
- c) Therefore, contention of Mr. Kumar is not correct and valid in law.

Question No.4. Discuss the taxability of gifts received by an Assessee.

1. Applicability: Gifts received by Individual and HUF irrespective of Residential Status.
2. Taxability: Any sum of **money, aggregate value of which exceeds Rs.50,000**, is received during the previous year without consideration, by an Individual or a HUF from any person(s) on or after 1.4.2006, then the **whole of the aggregate of such sum** will be taxable.
3. **Exceptions:**
 - (a) Gifts received from the following persons not taxable -
 - ✓ From a relative, or
 - ✓ On the occasion of the marriage of the individual, or

- ✓ Under a will or by way of inheritance, or
 - ✓ In contemplation of death of the payer, or
 - ✓ Any Local Authority, or Fund/Foundation/University/Educational Institution or Hospital or
 - ✓ other Medical Institution or
 - ✓ Trust or Institution referred u/s 10(23C), or
 - ✓ Trust / Institution registered u/s 12AA
- (b) Gifts received in kind not taxable.

4. **Relative means:**

- (a) Spouse of the individual,
- (b) Brother or sister of the individual,
- (c) Brother or sister of the spouse of the individual,
- (d) Brother or sister of either of the parents of the individual,
- (e) Any lineal ascendant or descendant of the individual,
- (f) Any lineal ascendant or descendant of the spouse of the individual,
- (g) Spouse of the person referred to in clauses (b) to (f) above.

Question No.5. B an individual, gets Rs.70,000 as a birthday gift from his Grandfather. Is the receipt taxable under the Income Tax Act? .

Answer: B has received the gift from his grandfather. Grandfather is a relative. Hence, the receipt is not taxable.

Question No.6. Discuss the taxability or otherwise of the following gifts received by H, an individual, during the Financial Year 2008-09:

- (a) Rs. 25,000 each from his four friends on the occasion of his birthday.
- (b) Wrist watch valued at Rs. 40,000 from his friend.

Answer:

- (a) Rs.1,00,000 (i.e. Rs. 25,000 × 4) from his four friends on the occasion of his birthday, is taxable as income from other sources, since friends are not relatives and the amount has exceeded Rs.50,000.
- (b) Gift in kind is not taxable. Hence, wrist watch of Rs.40,000 received as a gift from friend is not taxable.

Question No.7. Fiona received the following gifts during the year ending 31.03.2009:

- (a) Rs. 40, 000 from her elder sister.
 - (b) Rs.60,000 from the daughter of her elder sister.
 - (c) Rs. 1,25,000 from various friends on the occasion of her marriage,
- Discuss the taxability or otherwise of these gifts in the hands of Fiona.

Answer:

- (a) Rs.40,000 received from elder sister, is not taxable, as elder sister is a relative.
- (b) Rs.60,000 received from the daughter of her elder sister, is taxable, as the donor, in this case, is not a relative as per the definition of the Act.
- (c) Rs.1,25,000 is not taxable as it is received on the occasion of her marriage.

Question No.8. Discuss the taxability of Family Pension.

Answer:

Family pension means pension received by the family members of the deceased employee.

It is chargeable to tax under the head 'Income from Other Sources'.

Deduction u/s 57: Least of the following is allowed as a deduction -

- (a) 33 1/3 % of gross pension
- (b) Rs.15,000

Exemptions:

- (a) Family pension received by family members of Army personnel who are recipient of gallantry awards [Section 10(18)].
- (b) Family pension received by the widow or children or nominated heirs of a member of the armed forces (including para-military forces) whose death has occurred in the course of operational duties [Section 10(19)].

Question No.9. V. G. had placed a deposit of Rs. 10 Lakhs in a bank on which he received interest of Rs.80, 000. He had also borrowed Rs.5 Lakhs from the same bank on the security of the deposit and was liable to pay Rs.50,000 by way of interest to the bank. He therefore offered the difference between two amounts of Rs.30,000 as income from other sources. Is this correct?

Answer:

- (a) U/s 57, any expenditure (not being capital expenditure) expended to earn income chargeable under the head "Income from Other Sources" will be allowed as deduction against such income.
- (b) Interest on bank FD was the income in the hands of the assessee and the interest on the loan taken from bank on that deposit is not an allowable expenditure.

Therefore, in the given case, the interest of Rs.50,000 paid by VG is not allowable as deduction, and the entire interest of Rs.80,000 is fully taxable.

Question No.10. Shrey purchased in 2002, 10,000 Shares of Hero Ltd. for Rs.5 Lakhs by borrowing money from a bank. He holds them as 'Investments'. He received dividend during the previous year 2008-09. He has paid interest of Rs.85,000 on the loan to the bank during the previous year. Please advise Shrey, how should he deal with these facts in computing his income?

Answer:

- (a) In computation of total income under the Income Tax Act, the expenditure incurred in relation to income, which does not form part of Total Income, shall not be allowed as deduction. [Section 14A]
- (b) Dividend Income is exempt u/s 10(34) and hence does not form part of Total Income.

Therefore, the interest payment is not an allowable expenditure.

Question No.11. An assessee Company borrowed Rs.10 Lakhs for investment in debentures of a Company, The stipulated interest was 15% per annum and default in payment of interest would lead to the annual interest being added to the principal for levy of interest in subsequent years. The assessee defaulted in payment of interest for 2 years and in Assessment Year 2009-10 claimed the following payments: (a) interest for current year Rs.1,50,000 (b) On arrears of interest added to principal Rs.45,000

Consider the admissibility of the above claims u/s 57 of the Act.

Answer:

- (a) Where the interest on money borrowed for investment in shares had been allowed as a deduction in an earlier year but as the interest was not actually paid by the assessee to the lender then interest on arrears of interest shall not be allowed as deduction.
- (b) In view of the above judgement, the assessee being a Company, interest payable would have been claimed in earlier years against income from other sources.

Therefore, the interest on arrears of interest of Rs.45,000 shall not be allowed as deduction. Current year interest of Rs.1,50,000 will be allowed as deduction.

Question No.12. Z Ltd. is a company in which the public are not substantially interested. K is a shareholder of the company holding 15% of the equity shares. The accumulated profits of the company as on 31.03.2009 amounted to Rs. 10,00,000. The company lent Rs. 1,00,000 to K by an account payee bank draft on 01.10.2008. The loan was not connected with the business of the company. K repaid the loan to the company by an account payee bank draft on 30.03.2009. Examine the effect of the borrowal and repayment of the loan by K on the computation of his total income for the assessment year 2009-10.

Answer:

- (a) U/s 2(22)(e), payment of any sum by a Company in which the **public are not substantially interested**, by way of advance or loan, **to the extent the Company possesses accumulated profits**, to a shareholder, who is the beneficial owner of shares with **not less than 10% voting power, shall be deemed to be dividend**.
- (b) Analysis of given case and conclusion: In the given case Mr. K is a **beneficial owner of 15%** of voting power. Therefore, the amount of Rs. 1 Lakh so paid to him **shall be treated as deemed dividend u/s 2(22)(e)** even if the amount is repaid during the year.

Question No.13. Kaustav held 18% shares in a Private Limited Company. He gifted all the shares to his wife, Sarmistha on 1.10.2008. On 1.11.2008, Sarmistha obtained loan of Rs.80,000 from the Company, when the Company's accumulated profit was Rs.80,000. What are the Income Tax implications of the above transactions?

Answer:

- (a) U/s 2(22)(e), payment of any sum by a Company in which the public are not substantially interested, by way of advance or loan, to the extent the Company possesses accumulated profits, to a shareholder, who is the beneficial owner of shares with not less than 10% voting power, shall be deemed to be dividend.
- (b) In view of above, since Mrs. Sarmistha has 18% shareholding in a Private Limited Company, the loan amount of Rs.80,000 shall be treated as deemed dividend u/s 2(22)(e) in her hands.
- (c) Since the shares were gifted to Mrs. Sarmistha by her husband, Mr. Kaustav, the said amount of Rs.80,000 shall be clubbed in his total income and chargeable to tax.

Question No.14. A Company issued discount coupons to its shareholders which entitled them to purchase the products of the Company at a discount. The Assessing Officer feels that this is a disguised dividend. What are the arguments for and against such a treatment?

Arguments for treating discount coupons as Deemed Dividend u/s 2(22) (e):

- (a) Entitlement to such coupons arises only on account of shareholding and therefore coupons can be considered as release of profits otherwise than by way of actual disbursement.
- (b) The Company suffers a reduction in the gross value of sales to the extent the discount coupons are used and therefore it can be inferred that the assets to that extent get released indirectly in favour of the shareholders.

Arguments against treating discount coupons as Deemed Dividend u/s 2(22) (e):

- (a) Issue of discount coupons is a managerial decision and can be revoked at its discretion and therefore it cannot be treated at par with dividend.
- (b) There is no certainty that each shareholder will use the discount coupons. The coupons may be used or may not be used or it may be given to others who in turn may or may not use them. Again, it may be used wholly or partly.
- (c) The discount coupons do not necessarily confer any vested right in favour of the Shareholder and it does not create any liability for the Company to the Shareholder.

Question No.15. Mr.Salt is the Managing Director of Salt & Sons (Private) Ltd. The Company has accumulated profits to the extent of Rs.5 Lakhs as on 31.3.2009. It grants a loan of Rs.3 Lakhs to his wife on 1.6.2008 for the purchase of a house, which was repaid on 31.12.2008. No interest was charged on the said loan by the company. Examine the consequence of these transactions. Make assumptions as required.

Answer:

- (a) U/s 2(22)(e), payment of any sum by a Company in which the **public are NOT substantially interested**, by way of advance or loan, **to the extent the Company possesses accumulated profits**, to a shareholder, who is the beneficial owner of shares with **not less than 10% of voting power, shall be deemed to be dividend.**
- (b) In view of the above, **if Mrs.Salt is a beneficial owner of not less than 10% of voting power**, then the amount of Rs.3 Lakhs so paid to her **shall be treated as deemed dividend u/s 2(22)(e).**
- (c) If **Mr. Salt holds 10% or more** of the voting power, then the amount received shall be **treated as deemed dividend** in his hands.

Alternatively:

- (a) A loan given by a Company to its low paid employee, who in turn gives it to the Managing Director of the Company, shall be treated as deemed dividend u/s 2(22)(e) of the Act in the hands of the Managing Director.
- (b) If the loan given to Mrs.Salt has been utilized for the purpose of Mr. Salt, then applying the ratio upheld by the Supreme Court in the above case, the amount so received shall be treated as deemed dividend in his hands.

Question No.16. Explain the tax consequence of the transaction in the following case -

An assessee is carrying on business in the cultivation, manufacture and sale of tea. In the books of account maintained for the business there is an unexplained credit of Rs.50,000 which according to the assessee is attributable to possible omission from his source.

Answer:

- (a) U/s 68, any unexplained cash credit shall be treated as income of the previous year in which the books of account is being credited.
- (b) Unless the contrary is proved the credit entry may be attributed to the business of the Assessee.
- (c) Hence, in the given case, the unexplained credit entry of Rs.50,000 shall be treated as business income and eligible for application of Rule 8 i.e. 40% of such income shall be treated as business income i.e.Rs.20,000.
- (d) Therefore, the contention made by the Assessee is correct.

Question No.17. Hari incurred an expenditure of Rs.2 Lakhs, on the occasion of the marriage of his daughter on 28.1.2009. He has no explainable source for this expenditure. Has this any effect in Hari's Income Tax assessment for the Assessment Year 2009-10.

Answer:

- (a) U/s 69C, Unexplained Expenditure incurred by the assessee shall be treated as income under the head "Income from Other Sources".
- (b) It is chargeable to tax as the income of the previous year in which such expenditure was incurred.
- (c) In view of the above, the sum of Rs.2 Lakhs expended by Hari on his daughter's marriage shall be treated as income of the financial year 2008-09 and chargeable to tax.

Question No.18. Is an assessee liable to pay tax on rewards or awards received by him? [Section 10(17A)]

S, a film producer is awarded a cash prize of Rs.1 Lakh under the scheme of State award for films instituted by the Central Government. S claims this to be exempt from tax as a casual receipt.

1. Applicability of Sec. 10(17A): All individuals
2. Conditions.,
 - (a) The reward or award may be either in cash or in kind.
 - (b) The reward or award may be instituted by the Central or State Government or any other body approved by the Central or State Government.
3. In the given case S, a film producer, received a cash award of Rs.1 Lakh under the scheme of State award for films, instituted by the Central Government. Hence it is exempt u/s 10(17A).

19. Mr J K gets the following gifts during the previous year 2008-2009.

	Date of gift	Name of the donor	Amount of gift (Rs)
1.	01.07.2007	Gift from R, a friend, by cheque	50,000
2.	01.09.2007	Cash gift from N, nephew	1,00,000
3.	01.12.2007	Gift of diamond ring on his birthday, by a friend, C	75,000
4.	15.12.2007	Cash gifts of Rs. 31,000 each made by four friends on the occasion of his marriage	1,24,000
5.	01.12.2008	Cash gift made by wife's sister on house opening ceremony	51,000
6.	15.01.2008	Cash gift from a close friend of father-in-law.	1,51,000
7.	31.01.2008	Cash gift made by great-grandfather	1,51,000
8.	01.02.2008	Cash gift received under the Will of a friend, who is seriously ill.	51,000
9.	15.02.2008	Cash gift made by a business friend on his birthday	75,000
10.	31.03.2008	Cash gifts made by three friends of Rs. 25,000 each	

Besides this, JK is engaged in the business of sale and purchase of retail goods.

He maintains no account books. Gross turnover from retail trading is Rs 35,00,000.

Compute his total income for the assessment year 2009-2010.

Solution: Computation of taxable income for the AY 2009-2010

Particulars	Amount (Rs)
1. Income from retail trading business [Sec. 44 AF] 5% Rs 35,00,000	1,75,000
2. Income from other sources (money gifts):	
(i) Cash gift from a friend, by cheque	50,000
(ii) Cash gift from nephew, not covered by the definition of relative	1,00,000
(iii) Gift of diamond ring—non-monetary gift not taxable	—
(iv) Cash gifts on the occasion of marriage are not chargeable even if such gifts are made by unrelated persons	—
(v) Cash gift made by wife's sister, a relative, not taxable	—
(vi) Cash gift by a friend of father-in-law, unrelated person	1,51,000
(vii) Cash gift made by great-grand father, a relative	—
(viii) Cash gift received under Will in contemplation of death of a friend	—
(ix) Cash gift made by a business friend on his birthday	51,000
(x) Cash gifts, made by three friends, of Rs 25,000 each	75,000
Total income	6,02,000

20. Mr Ayan Goel receives the following gifts of of money:

S. No.	Date of gift	Donor	Form of gift	Amount of gifts	Remarks
1.	31.3.2008	Friend	Cheque	25,000	Cheque is encashed on 03.04.2008
2.	01.05.2008	Brother	Bank draft	50,000	
3.	30.07.2008	Non-resident friend	Cheque	30,000	
4.	01.10.2008	Brother-in-law	Cash	10,000	
5.	15.11.2008	Great-grandfather-in-law	Cash	40,000	On the occasion of the marriage Maturity date 31.03.2009
6.	05.12.2008	Cousin brother	Cash	21,000	
7.	01.01.2009	Neighbour	NSC-VIII Issue	10,000	
8.	31.03.2009	Friend	Cash	10,000	

Determine the chargeability of the aforesaid gifts. Would it make any difference if the amount of gift made on 31.03.2009 is Rs 10,001.

Solution: Computation of taxable gifts for the AY 2009-2010

	Particulars	Case – I Rs	Case – II Rs
1.	Gift of cheque dated 31.03.2008 from a friend but encashed on 03.04.2007 is not taxable since it does not exceed Rs 25,000. Chargeability is governed by the date of receipt and not by date of encashment.	—	—
2.	Gift from brother is exempt	—	—
3.	Gift from friend	30,000	30,000
4.	Gift from brother-in-law—Exempt	—	—
5.	Gift from great grandfather-in-law: Exempt	—	—
6.	Gift on the occasion of the marriage	—	—
7.	Gift from neighbour	10,000	10,000
8.	Gift from friend	10,000	10,000
		<u>50,000</u>	<u>50,000</u>
	Taxable gift	Exempt	50,001