

UNIT 1 : Income From Salaries

Question 1

Mr. Harish, aged 52 years, is the Production Manager of XYZ Ltd. From the following details, compute the taxable income for the assessment year 2013-14.

Basic salary	₹ 50,000 per month
Dearness allowance	40% of basic salary
Transport allowance (for commuting between place of residence and office)	₹ 3,000 per month
Motor car running and maintenance charges fully paid by employer (The motor car is owned by the company and driven by the employee. The engine cubic capacity is above 1.60 litres. The motor car is used for both official and personal purpose by the employee.)	₹ 60,000
Expenditure on accommodation in hotels while touring on official duties met by the employer	₹ 80,000
Loan from recognized provident fund (maintained by the employer)	₹ 60,000
Lunch provided by the employer during office hours.	
Cost to the employer	₹ 24,000
Computer (cost ₹ 35,000) kept by the employer in the residence of Mr. Harish from 1.06.2012	
Mr. Harish made the following payments:	
Medical insurance premium: Paid in Cash	₹ 4,800
Paid by account payee crossed cheque	₹ 15,200

Answer

Computation of taxable income of Mr. Harish for the A.Y.2013-14

Particulars	₹	₹
Basic salary (₹ 50,000 x 12)		6,00,000
Dearness allowance @ 40% of basic salary		2,40,000
Transport allowance (₹ 3,000 x 12)	36,000	
Less : Exemption under section 10(14) (₹ 800 x 12)	9,600	26,400

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Motor car running & maintenance charges paid by employer (See Note-1)		28,800
Expenditure on accommodation in hotels while touring on official duty is not a perquisite in the hands of employee and hence not chargeable to tax		Nil
Loan from recognized provident fund – not chargeable to tax		Nil
Value of lunch provided during office hours	24,000	
Less: Exempt under Rule 3(7)(iii) (See Note-2)	<u>15,000</u>	9,000
Computer provided in the residence of employee by the employer – not chargeable to tax [Rule 3(7)(vii)]		<u>Nil</u>
Gross Salary		9,04,200
Less : Deduction under Chapter VI-A		
Deduction under section 80D in respect of medical insurance premium paid by cheque amounting to ₹ 15,200 but restricted to (See Note-3)		<u>15,000</u>
Taxable income		<u>8,89,200</u>

Notes:

- As per Rule 3(2), if the motor car (whose engine cubic capacity is above 1.60 litres) is owned by the employer and is used for both official and personal purpose by the employee, then the value of perquisite for use of motor car would be ₹ 2,400 per month.
Therefore value of perquisite for use of motor car would be ₹ 2,400 x 12 = ₹ 28,800
- As per Rule 3(7)(iii), lunch provided by the employer during office hours is not considered as perquisite upto ₹ 50 per meal. Since, the number of working days is not given in the question, it is assumed to be 300 days during the F.Y. 2012-13. Therefore, ₹ 15,000 (i.e. 300 x ₹ 50) would be exempt and the balance ₹ 9,000 (i.e. ₹ 24,000 - ₹ 15,000) would be taxable.
- Medical insurance premium paid in cash of ₹ 4,800 is not allowable as deduction under section 80D. Further, deduction for medical insurance premium paid through cheque is restricted to ₹ 15,000, which is the maximum deduction allowable.

Question 2

Mr. Ashok, an employee of a PSU, furnishes the following particulars for the previous year ending 31.03.2013.

Particulars	₹
(i) Salary income for the year	7,25,000
(ii) Salary for financial year 2009-10 received during the year	80,000
(iii) Assessed income for the financial year 2009-10	2,40,000

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 2013-14.

The rates of income tax for the assessment year 2010-11 are :

	Tax rate (%)
On first ₹ 1,60,000	Nil
On ₹ 1,60,000 – ₹ 3,00,000	10
On ₹ 3,00,000 – ₹ 5,00,000	20
Above ₹ 5,00,000	30
Education cess	3

Answer

Computation of relief under section 89 of Mr. Ashok for the A.Y. 2013-14

Particulars	₹	₹
Assessment year 2013-14		
Salary Income for the year excluding arrears		7,25,000
Add: Arrears relating to Financial Year 2009-10		<u>80,000</u>
Total Income (including arrears)		<u>8,05,000</u>
Tax on ₹ 8,05,000		
First ₹ 2,00,000 Nil	Nil	
Next ₹ 3,00,000 10%	30,000	
Balance ₹ 3,05,000 20%	<u>61,000</u>	
₹ 8,05,000	91,000	
Add: Education cess @ 2%	1,820	
Secondary and higher education cess @1%	<u>910</u>	
Tax on total income (including arrears) (A)	<u>93,730</u>	
Total Income excluding arrears		7,25,000
Tax on ₹ 7,25,000		
First ₹ 2,00,000 Nil	Nil	
Next ₹ 3,00,000 10%	30,000	
Balance ₹ 2,25,000 20%	<u>45,000</u>	
₹ 7,25,000	75,000	
Add : Education cess @ 2%	1,500	
Secondary and higher education cess @ 1%	<u>750</u>	
Tax on total income (excluding arrears) (B)	<u>77,250</u>	

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Difference between A & B	I		16,480
Assessment Year 2010-11			
Total Income assessed			2,40,000
Add: Arrears relating to Financial year 2009-10			<u>80,000</u>
Total income (including arrears)			<u>3,20,000</u>
Tax on ₹ 3,20,000		18,000	
Add: Education Cess @ 2%		360	
Secondary and higher education cess @1%		<u>180</u>	
Tax on total income (including arrears)	(C)	<u>18,540</u>	
Total Income excluding arrears			2,40,000
Tax on ₹ 2,40,000		8,000	
Add: Education Cess @ 2%		160	
Secondary and higher education cess @1%		<u>80</u>	
Tax on total income (excluding arrears)	(D)	<u>8,240</u>	
Difference between C & D	II		10,300
Relief under section 89	(I – II)		6,180

Note: It has been assumed that salary income of ₹ 7,25,000 for the year, as given in the question, does not include salary of ₹ 80,000 for the F.Y. 2009-10 received during the year.

Question 3

Mr. Mohit is employed with XY Ltd. on a basic salary of ₹ 10,000 p.m. He is also entitled to dearness allowance @ 100% of basic salary, 50% of which is included in salary as per terms of employment. The company gives him house rent allowance of ₹ 6,000 p.m. which was increased to ₹ 7,000 p.m. with effect from 1.01.2013. He also got an increment of ₹ 1,000 p.m. in his basic salary with effect from 1.02.2013. Rent paid by him during the previous year 2012-13 is as under:

April and May, 2012	-	Nil, as he stayed with his parents
June to October, 2012	-	₹ 6,000 p.m. for an accommodation in Ghaziabad
November, 2012 to March, 2013	-	₹ 8,000 p.m. for an accommodation in Delhi.

Compute his gross salary for assessment year 2013-14.

Answer

Computation of gross salary of Mr. Mohit for A.Y. 2013-14

Particulars	₹
Basic salary [(₹ 10,000 × 10) + (₹ 11,000 × 2)]	1,22,000
Dearness Allowance (100% of basic salary)	1,22,000

House Rent Allowance (See Note below)	<u>21,300</u>
Gross Salary	<u>2,65,300</u>

Note: Computation of Taxable House Rent Allowance (HRA)

Particulars	April-May (₹)	June-Oct (₹)	Nov-Dec (₹)	Jan (₹)	Feb-March (₹)
Basic salary per month	10,000	10,000	10,000	10,000	11,000
Dearness allowance (included in salary as per terms of employment) (50% of basic salary)	<u>5,000</u>	<u>5,000</u>	<u>5,000</u>	<u>5,000</u>	<u>5,500</u>
Salary per month for the purpose of computation of house rent allowance	<u>15,000</u>	<u>15,000</u>	<u>15,000</u>	<u>15,000</u>	<u>16,500</u>
Relevant period (in months)	2	5	2	1	2
Salary for the relevant period (Salary per month × relevant period)	30,000	75,000	30,000	15,000	33,000
Rent paid for the relevant period	Nil	30,000 (₹6,000×5)	16,000 (₹8,000×2)	8,000 (₹8,000×1)	16,000 (₹8,000×2)
House rent allowance (HRA) received during the relevant period (A)	12,000 (₹6,000×2)	30,000 (₹6,000×5)	12,000 (₹6,000×2)	7,000 (₹7,000×1)	14,000 (₹7,000×2)
Least of the following is exempt [u/s 10(13A)]					
1. Actual HRA received	12,000	30,000	12,000	7,000	14,000
2. Rent paid – 10% of salary	N.A.	22,500	13,000	6,500	12,700
3. 40% of salary (Residence at Ghaziabad–June to Oct, 2012)	N.A.	30,000 (40% × ₹75,000)			
50% of salary (Residence at Delhi–Nov'12- March'13)			15,000 (50% × ₹30,000)	7,500 (50% × ₹15,000)	16,500 (50% × ₹33,000)
Exempt HRA (B)	Nil	22,500	12,000	6,500	12,700
Taxable HRA (Actual HRA – Exempt HRA) (A-B)	12,000	7,500	Nil	500	1,300

Taxable HRA (total) = ₹ 12,000 + ₹ 7,500 + ₹ 500 + ₹ 1,300 = ₹ 21,300

Question 4

Mr. X retired from the services of M/s Y Ltd. on 31.01.2013 after completing service of 30 years and one month. He had joined the company in 1980 at the age of 30 years and received the following on his retirement :

- (i) Gratuity ₹ 6,00,000. He was covered under the Payment of Gratuity Act, 1972.
- (ii) Leave encashment of ₹ 3,30,000 for 330 days leave balance in his account. He was credited 30 days leave for each completed year of service.
- (iii) As per the scheme of the company, he was offered a car which was purchased on 01.02.2010 by the company for ₹ 5,00,000. Company has recovered ₹ 2,00,000 from him for the car. Company depreciates the vehicles at the rate of 15% on Straight Line Method.
- (iv) An amount of ₹ 3,00,000 as commutation of pension for 2/3 of his pension commutation.
- (v) Company presented him a gift voucher worth ₹ 6,000 on his retirement.
- (vi) His colleagues also gifted him a Television (LCD) worth ₹ 50,000 from their own contribution.

Following are the other particulars :

- (i) He has drawn a basic salary of ₹ 20,000 and 50% dearness allowance per month for the period from 01.04.2012 to 31.01.2013.
- (ii) Received pension of ₹ 5,000 per month for the period 01.02.2013 to 31.03.2013 after commutation of pension.

Compute his gross total income from the above for Assessment Year 2013-14.

Answer**Computation of Gross Total Income of Mr. X for A.Y. 2013-14**

Particulars	₹
Basic Salary = ₹ 20,000 x 10	2,00,000
Dearness Allowance = 50% of basic salary	1,00,000
Gift Voucher (See Note - 1)	6,000
Transfer of car (See Note - 2)	56,000
Gratuity (See Note - 3)	80,769
Leave encashment (See Note - 4)	1,30,000
Uncommuted pension = ₹ 5000 x 2	10,000
Commuted pension (See Note - 5)	<u>1,50,000</u>
Taxable Salary /Gross Total Income	<u>7,32,769</u>

Notes -

- (1) As per Rule 3(7)(vi), the value of any gift or voucher or token in lieu of gift received by the employee or by member of his household not exceeding ₹ 5,000 in aggregate during the previous year is exempt. In this case, the amount was received on his retirement and the sum exceeds the limit of ₹ 5,000.

Therefore, the entire amount of ₹ 6,000 is liable to tax as perquisite.

Note - An alternate view possible is that only the sum in excess of ₹ 5,000 is taxable in view of the language of Circular No.15/2001 dated 12.12.2001 that such gifts upto ₹ 5,000 in the aggregate per annum would be exempt, beyond which it would be taxed as a perquisite. As per this view, the value of perquisite would be ₹ 1,000 and gross taxable income would be ₹ 7,27,769.

- (2) **Perquisite value of transfer of car:** As per Rule 3(7)(viii), the value of benefit to the employee, arising from the transfer of an asset, being a motor car, by the employer is the actual cost of the motor car to the employer as reduced by 20% of such cost for each completed year during which such motor car was put to use by the employer on a written down value basis. Therefore, the value of perquisite on transfer of motor car, in this case, would be:

Particulars	₹
Purchase price (1.2.2010)	5,00,000
Less: Depreciation @ 20%	<u>1,00,000</u>
WDV on 31.1.2011	4,00,000
Less: Depreciation @ 20%	<u>80,000</u>
WDV on 31.1.2012	3,20,000
Less: Depreciation @ 20%	<u>64,000</u>
WDV on 31.1.2013	2,56,000
Less: Amount recovered	<u>2,00,000</u>
Value of perquisite	<u>56,000</u>

The rate of 15% as well as the straight line method adopted by the company for depreciation of vehicle is not relevant for calculation of perquisite value of car in the hands of Mr. X.

- (3) **Taxable gratuity**

Particulars	₹
Gratuity received	6,00,000
Less : Exempt under section 10(10) - Least of the following:	
(i) Notified limit = ₹ 10,00,000	

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(ii) Actual gratuity =	₹ 6,00,000	
(iii) $15/26 \times 30,000 \times 30 =$	₹ 5,19,231	<u>5,19,231</u>
Taxable Gratuity		<u>80,769</u>

(4) Taxable leave encashment

Particulars	₹
Leave Salary received	3,30,000
Less : Exempt under section 10(10AA) - Least of the following:	
(i) Notified limit	₹ 3,00,000
(ii) Actual leave salary	₹ 3,30,000
(iii) 10 months x ₹ 20,000 (assuming that dearness allowance does not form part of pay for retirement benefit)	₹ 2,00,000
(iv) Cash equivalent of leave to his credit $\left(\frac{330}{30} \times 20,000 \right)$	₹ 2,20,000
	<u>2,00,000</u>
Taxable Leave encashment	<u>1,30,000</u>

Note – It has been assumed that dearness allowance does not form part of salary for retirement benefits. In case it is assumed that dearness allowance forms part of pay for retirement benefits, then, the third limit for exemption under section 10(10AA) in respect of leave encashment would be ₹ 3,00,000 (i.e. 10 x ₹ 30,000) and the fourth limit ₹ 3,30,000, in which case, the taxable leave encashment would be ₹ 30,000 (₹ 3,30,000 - ₹ 3,00,000). In such a case, the gross total income would be ₹ 6,32,769.

(5) Commuted Pension

Since Mr. X is a non-government employee in receipt of gratuity, exemption under section 10(10A) would be available to the extent of $1/3^{\text{rd}}$ of the amount of the pension which he would have received had he commuted the whole of the pension.

Particulars	₹
Amount received	3,00,000
Exemption under section 10(10A) = $\frac{1}{3} \times \left[3,00,000 \times \frac{3}{2} \right]$	<u>1,50,000</u>
Taxable amount	<u>1,50,000</u>

- (6) The taxability provisions under section 56(2)(vii) are not attracted in respect of television received from colleagues, since television is not included in the definition of property therein.

Question 5

Mr. Balaji, employed as Production Manager in Beta Ltd., furnishes you the following information for the year ended 31.03.2013:

- (i) Basic salary upto 31.10.2012 ₹ 50,000 p.m.
Basic salary from 01.11.2012 ₹ 60,000 p.m.
Note: Salary is due and paid on the last day of every month.
- (ii) Dearness allowance @ 40% of basic salary.
- (iii) Bonus equal to one month salary. Paid in October 2012 on basic salary plus dearness allowance applicable for that month.
- (iv) Contribution of employer to recognized provident fund account of the employee @ 16% of basic salary.
- (v) Profession tax paid ₹ 3,000 of which ₹ 2,000 was paid by the employer.
- (vi) Facility of laptop and computer was provided to Balaji for both official and personal use. Cost of laptop ₹ 45,000 and computer ₹ 35,000 were acquired by the company on 01.12.2012.
- (vii) Motor car owned by the employer (cubic capacity of engine exceeds 1.60 litres) provided to the employee from 01.11.2012 meant for both official and personal use. Repair and running expenses of ₹ 45,000 from 01.11.2012 to 31.03.2013, were fully met by the employer. The motor car was self-driven by the employee.
- (viii) Leave travel concession given to employee, his wife and three children (one daughter aged 7 and twin sons aged 3). Cost of air tickets (economy class) reimbursed by the employer ₹ 30,000 for adults and ₹ 45,000 for three children. Balaji is eligible for availing exemption this year to the extent it is permissible in law.

Compute the salary income chargeable to tax in the hands of Mr. Balaji for the assessment year 2013-14.

Answer**Computation of Taxable Salary of Mr. Balaji for A.Y. 2013-14**

Particulars	₹
Basic salary [(₹ 50,000 × 7) + (₹ 60,000 × 5)]	6,50,000
Dearness Allowance (40% of basic salary)	2,60,000
Bonus (₹ 50,000 + 40% of ₹ 50,000) (See Note 1)	70,000
Employers Contribution to Recognised Provident Fund in excess of 12% of salary = 4% of ₹ 6,50,000 (See Note 4)	26,000
Professional tax paid by employer	2,000

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Perquisite of Motor Car (₹ 2,400 for 5 months) (See Note 5)	<u>12,000</u>
Gross Salary	10,20,000
Less: Deduction under section 16	
Professional tax (See Note 6)	<u>3,000</u>
Taxable Salary	<u>10,17,000</u>

Notes:

1. Since bonus was paid in the month of October, the basic salary of ₹ 50,000 for the month of October is considered for its calculation.
2. As per Rule 3(7)(vii), facility of use of laptop and computer is an exempt perquisite, whether used for official or personal purpose or both.
3. Mr. Balaji can avail exemption under section 10(5) on the entire amount of ₹ 75,000 reimbursed by the employer towards Leave Travel Concession since the same was availed for himself, his wife and three children and the journey was undertaken by economy class airfare. The restriction imposed for two children is not applicable in case of multiple births which take place after the first child.

It is assumed that the Leave Travel Concession was availed for journey within India.

4. It is assumed that dearness allowance does not form part of salary for computing retirement benefits.
5. As per the provisions of Rule 3(2), in case a motor car (engine cubic capacity exceeding 1.60 liters) owned by the employer is provided to the employee without chauffeur for personal as well as office use the value of perquisite shall be ₹ 2,400 per month. The car was provided to the employee from 01.11.2012 therefore, the perquisite value has been calculated for 5 months.
6. As per section 17(2)(iv), a "perquisite" includes any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee. Therefore, professional tax of ₹ 2,000 paid by the employer is taxable as a perquisite in the hands of Mr. Balaji. As per section 16(iii), a deduction from the salary is provided on account of tax on employment i.e. professional tax paid during the year.

Therefore, in the present case, the professional tax paid by the employer on behalf of the employee ₹ 2,000 is first included in the salary and deduction of the entire professional tax of ₹ 3,000 is provided from salary.

Question 6

Shri Bala employed in ABC Co. Ltd. as Finance Manager gives you the list of perquisites provided by the company to him for the entire financial year 2012-13:

- (i) *Medical facility given to his family in a hospital maintained by the company. The estimated value of benefit because of such facility is ₹ 40,000.*

- (ii) Domestic servant was provided at the residence of Bala. Salary of domestic servant is ₹ 1,500 per month. The servant was engaged by him and the salary is reimbursed by the company (employer).

In case the company has employed the domestic servant, what is the value of perquisite?

- (iii) Free education was provided to his two children Arthy and Ashok in a school maintained and owned by the company. The cost of such education for Arthy is computed at ₹ 900 per month and for Ashok at ₹ 1,200 per month. No amount was recovered by the company for such education facility from Bala.
- (iv) The employer has provided movable assets such as television, refrigerator and air-conditioner at the residence of Bala. The actual cost of such assets provided to the employee is ₹ 1,10,000.
- (v) A gift voucher worth ₹ 10,000 was given on the occasion of his marriage anniversary. It is given by the company to all employees above certain grade.

State the taxability or otherwise of the above said perquisites and compute the total value of taxable perquisites.

Answer

Taxability of perquisites provided by ABC Co. Ltd. to Shri Bala

- (i) Medical facility to employees' family in a hospital maintained by the employer is not a taxable perquisite. Regardless of the estimated value of benefit arising from such facility to the employee, it is exempt from tax. Therefore, the value of perquisite is Nil.
- (ii) Domestic servant was employed by the employee and the salary of such domestic servant was paid/reimbursed by the employer. It is taxable as perquisite for all categories of employees.

Taxable perquisite value = ₹ 1,500 × 12 = ₹ 18,000.

If the company had employed the domestic servant and the facility of such servant is given to the employee, then the perquisite is taxable only in the case of specified employees. The value of the taxable perquisite in such a case also would be ₹ 18,000.

- (iii) Where the educational institution is owned by the employer, the value of perquisite in respect of free education facility shall be determined with reference to the reasonable cost of such education in a similar institution in or near the locality. However, there would be no perquisite if the cost of such education per child does not exceed ₹ 1,000 per month.

Therefore, there would be no perquisite in respect of cost of free education provided to his child Arthy, since the cost does not exceed ₹ 1,000 per month.

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However, the cost of free education provided to his child Ashok would be taxable, since the cost exceeds ₹ 1,000 per month. The taxable perquisite value would be ₹ 14,400 ($₹ 1,200 \times 12$).

Note – An alternate view possible is that only the sum in excess of ₹ 1,000 per month is taxable. In such a case, the value of perquisite would be ₹ 2,400.

- (iv) Where the employer has provided movable assets to the employee or any member of his household, 10% per annum of the actual cost of such asset owned or the amount of hire charges incurred by the employer shall be the value of perquisite. However, this will not apply to laptops and computers. In this case, the movable assets are television, refrigerator and air conditioner and actual cost of such assets is ₹ 1,10,000.

The perquisite value would be 10% of the actual cost i.e., ₹ 11,000, being 10% of ₹ 1,10,000.

- (v) The value of any gift or voucher or token in lieu of gift received by the employee or by member of his household not exceeding ₹ 5,000 in aggregate during the previous year is exempt. In this case, the amount was received on the occasion of marriage anniversary and the sum exceeds the limit of ₹ 5,000.

Therefore, the entire amount of ₹ 10,000 is liable to tax as perquisite.

Note - An alternate view possible is that only the sum in excess of ₹ 5,000 is taxable in view of the language of Circular No.15/2001 dated 12.12.2001 that such gifts upto ₹ 5,000 in the aggregate per annum would be exempt, beyond which it would be taxed as a perquisite. As per this view, the value of perquisite would be ₹ 5,000.

Total value of taxable perquisite = ₹ 53,400 [i.e. ₹ 18,000 + 14,400 + 11,000 + 10,000].

Note - In case the alternate views are taken for items (iii) & (v), the total value of taxable perquisite would be ₹ 36,400 [i.e., ₹ 18,000 + 2,400 + 11,000 + 5,000].

Question 7

Mr. Shah, an Accounts Manager, has retired from JK Ltd. on 15.1.2013 after rendering services for 30 years 7 months. His salary is ₹ 25,000/- p.m. upto 30.09.2012 and ₹ 27,000/- thereafter. He also gets ₹ 2,000/- p.m. as dearness allowance (55% of it is a part of salary for computing retirement benefits). He is not covered by the Payment of Gratuity Act, 1972. He has received ₹ 8 Lacs as gratuity from the employer company. Compute the gratuity taxable in the hands of Mr. Shah.

Answer

Computation of gratuity taxable in the hands of Mr. Shah for the P.Y. 2012-13

As per section 10(10)(iii), gratuity received by an employee would be exempt upto the least of the following limits -

S.No.	Particulars	₹
(i)	Gratuity received	8,00,000
(ii)	Half-month's salary for every year of completed service (See Note below)	4,00,500
(iii)	Monetary limit	10,00,000

Therefore, ₹ 4,00,500 would be exempt under section 10(10)(iii). The balance ₹ 3,99,500 (i.e. ₹ 8,00,000 – ₹ 4,00,500) would be taxable.

Note:-

One of the limits for calculation of gratuity exempt under section 10(10)(iii) is one-half-month's salary for each year of completed service (fraction of a year to be ignored), calculated on the basis of average salary for the ten months immediately preceding the month of retirement. In this case, the month of retirement is January, 2013. Therefore, average salary for the months of March 2012 to December 2012 have to be considered. The salary is ₹ 25,000 p.m. upto 30.9.2012 and ₹ 27,000 p.m. from 1.10.2012. Hence, average salary would be ₹ 26,700 $[(₹ 25,000 \times 7) + (₹ 27,000 \times 3) + (2000 \times 55\% \times 10)]/10$.

Further, half-month's salary should be multiplied by the number of years of completed service and any fraction of a year has to be ignored. Therefore, in this case, half-month's salary should be multiplied by 30 and the fraction of 7 months should be ignored.

Computation of average salary	₹
Basic salary March 2012 to December 2012 $(25,000 \times 7 + 27,000 \times 3)$	2,56,000
Dearness allowance $(2,000 \times 10 \times 55\%)$	<u>11,000</u>
	<u>2,67,000</u>
Average salary = $2,67,000/10 = ₹ 26,700$	
Half-month's salary for every year of completed service (fraction is to be ignored) $[30 \times 26,700/2]$	4,00,500

Question 8

From the following details, find out the salary chargeable to tax for the assessment year 2013-14 -

Mr. X is a regular employee of Rama & Co. in Gurgaon. He was appointed on 1.1.2012 in the scale of 20,000-1,000-30,000. He is paid 10% D.A. & Bonus equivalent to one month pay based on salary of March every year. He contributes 15% of his pay and D.A. towards his recognized provident fund and the company contributes the same amount.

He is provided free housing facility which has been taken on rent by the company at ₹ 10,000 per month. He is also provided with following facilities:

- (i) Facility of laptop costing ₹ 50,000.

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- (ii) Company reimbursed the medical treatment bill of his brother of ₹ 25,000, who is dependent on him.
- (iii) The monthly salary of ₹ 1,000 of a house keeper is reimbursed by the company.
- (iv) A gift voucher of ₹ 10,000 on the occasion of his marriage anniversary.
- (v) Conveyance allowance of ₹ 1,000 per month is given by the company towards actual reimbursement.
- (vi) He is provided personal accident policy for which premium of ₹ 5,000 is paid by the company.
- (vii) He is getting telephone allowance @ ₹ 500 per month.
- (viii) Company pays medical insurance premium of his family of ₹ 10,000.

Answer

Computation of taxable salary of Mr.X for A.Y. 2013-14

Particulars	₹
Basic pay [(₹ 20,000×9) + (₹ 21,000×3)] = ₹ 1,80,000 + ₹ 63,000	2,43,000
Dearness allowance [10% of basic pay]	24,300
Bonus	21,000
Employer's contribution to Recognized Provident Fund in excess of 12% (15%-12% =3% of ₹ 2,67,300) [See Note 1 below]	8,019
Taxable allowances	
Telephone allowance	6,000
Taxable perquisites	
Rent-free accommodation [See Note 1 & 2 below]	44,145
Medical reimbursement (₹ 25,000 - ₹ 15,000) [See Note 4 below]	10,000
Reimbursement of salary of housekeeper	12,000
Gift voucher [See Note 6 below]	<u>10,000</u>
Salary income chargeable to tax	<u>3,78,464</u>

Notes:

1. It has been assumed that dearness allowance forms part of salary for retirement benefits and accordingly, the perquisite value of rent-free accommodation and employer's contribution to recognized provident fund have been worked out.
2. Where the accommodation is taken on lease or rent by the employer, the value of rent-free accommodation provided to employee would be actual amount of lease rental paid or payable by the employer or 15% of salary, whichever is lower.

For the purposes of valuation of rent free house, salary includes:

- (i) Basic salary i.e., ₹ 2,43,000
- (ii) Dearness allowance (assuming that it is included for calculating retirement benefits) i.e. ₹ 24,300
- (iii) Bonus i.e., ₹ 21,000
- (iv) Telephone allowance i.e., ₹ 6,000

Therefore, salary works out to

$$2,43,000 + 24,300 + 21,000 + 6,000 = 2,94,300.$$

$$15\% \text{ of salary} = 2,94,300 \times 15/100 = 44,145$$

Value of rent-free house = Lower of rent paid by the employer (i.e. ₹ 1,20,000) or 15% of salary (i.e., ₹ 44,145).

Therefore, the perquisite value is ₹ 44,145.

3. Facility of use of laptop is not a taxable perquisite.
4. Clause (v) of the proviso to section 17(2) exempts any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family to the extent of ₹ 15,000. Therefore, in this case, the balance of ₹ 10,000 (i.e., ₹ 25,000 – ₹ 15,000) is a taxable perquisite. Medical insurance premium paid by employer is exempt.
5. Conveyance allowance is exempt since it is based on actual reimbursement for official purposes.
6. The value of any gift or voucher or token in lieu of gift received by the employee or by member of his household not exceeding ₹ 5,000 in aggregate during the previous year is exempt. In this case, the gift voucher was received on the occasion of marriage anniversary and the sum exceeds the limit of ₹ 5,000.

Therefore, the entire amount of ₹ 10,000 is liable to tax as perquisite.

Note - An alternate view possible is that only the sum in excess of ₹ 5,000 is taxable in view of the language of Circular No.15/2001 dated 12.12.2001 that such gifts upto ₹ 5,000 in the aggregate per annum would be exempt, beyond which it would be taxed as a perquisite. As per this view, the value of perquisite would be ₹ 5,000.

7. Premium of ₹ 5,000 paid by the company for personal accident policy is not liable to tax.

Question 9

AB Co. Ltd. allotted 1000 sweat equity shares to Sri Chand in June 2012. The shares were allotted at ₹ 200 per share as against the fair market value of ₹ 300 per share on the date of exercise of option by the allottee viz. Sri Chand. The fair market value was computed in accordance with the method prescribed under the Act.

4.16 Income-tax

- (i) What is the perquisite value of sweat equity shares allotted to Sri Chand?
- (ii) In the case of subsequent sale of those shares by Sri Chand, what would be the cost of acquisition of those sweat equity shares?

Answer

- (i) As per section 17(2)(vi), the value of sweat equity shares chargeable to tax as perquisite shall be the fair market value of such shares on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from, the assessee in respect of such shares.

Particulars	₹
Fair market value of 1000 sweat equity shares @ ₹ 300 each	3,00,000
Less: Amount recovered from Sri Chand 1000 shares @ ₹ 200 each	2,00,000
Value of perquisite of sweat equity shares allotted to Sri Chand	1,00,000

- (ii) As per section 49(2AA), where capital gain arises from transfer of sweat equity shares, the cost of acquisition of such shares shall be the fair market value which has been taken into account for perquisite valuation under section 17(2)(vi).

Therefore, in case of subsequent sale of sweat equity shares by Sri Chand, the cost of acquisition would be ₹ 3,00,000.

Question 10

- (i) Mr. Khanna, an employee of IOL, New Delhi, a private sector company, received the following for the financial year 2012-13:

Sl. No.	Particulars	₹
1.	Basic pay	1,20,000
2.	House rent allowance	1,00,000
3.	Special allowance	30,000

Mr. Khanna was residing at New Delhi and was paying a rent of ₹ 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 ₹ 10,000 per month to the landlord and recovers a sum of ₹ 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:

	Particulars	₹	₹
(a)	Actual house rent allowance (HRA) received		1,00,000
(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 ₹ 1,20,000)	<u>12,000</u>	1,08,000
(c)	50% of salary (i.e. 50% of ₹ 1,20,000)		60,000

Least of the above is ₹ 60,000.

The house rent allowance received by Mr. Khanna would be exempt to the extent of ₹ 60,000 under section 10(13A). The balance of ₹ 40,000 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 x 12 = ₹ 1,20,000

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

Lower of the above is ₹ 22,500, which should be reduced by the rent of ₹ 30,000 paid by the employee (i.e. 2,500 x 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.

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

4.18 Income-tax

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 1, Mr. Khanna should opt for HRA, which would be more beneficial to him.

Working Notes :

1. Computation of tax under Option 1 (HRA):

Particulars	₹
Salary:	
Basic Pay	1,20,000
HRA (taxable)	40,000
Special allowance	<u>30,000</u>
Total salary	<u>1,90,000</u>
Tax on ₹ 1,90,000 (including cess)	Nil

2. Computation of tax under Option 2 (Concessional accommodation)

Particulars	₹
Salary:	
Basic Pay	1,20,000
Special allowance	30,000
Concessional accommodation	<u>Nil</u>
Total salary	<u>1,50,000</u>
Tax on ₹ 1,50,000	Nil

Question 11

Shri Hari is the General Manager of ABC Ltd. From the following details, compute the taxable income for the Assessment year 2013-14 :

Basic salary	₹ 20,000 per month
Dearness allowance	30% of basic salary
Transport allowance (for commuting between place of residence and office)	₹ 2,000 per month
Motor car running and maintenance charges fully paid by employer	₹ 36,000
(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)	
Expenditure on accommodation in hotels while touring on official duties met by the employer.	₹ 30,000
Loan from recognised provident fund (maintained by the employer)	₹ 40,000
Lunch provided by the employer during office hours.	
Cost to the employer	₹ 12,000
Computer (cost ₹ 50,000) kept by the employer in the residence of Hari from 1.10.2012	
Hari made the following payments:	
Medical insurance premium : Paid in cash	₹ 2,000
Paid by cheque	₹ 3,200

Answer**Computation of taxable income of Shri Hari for the A.Y. 2013-14**

Particulars	₹	₹
Basic salary (₹ 20,000 x 12)		2,40,000
Dearness allowance @ 30%		72,000
Transport allowance (₹ 2,000 x 12)	24,000	
Less : Exemption under section 10(14) (read with Rule 2BB @ ₹ 800 p.m.)	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 as per rule 3(7)(iii)		Nil
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 under section 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

Question 12

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 13

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 ₹ 500 per month, his employer reimbursed the entire salary paid to the domestic servant i.e. ₹ 500 per month.*
- (ii) *For Mr. Y, he was provided with a domestic servant @ ₹ 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 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 14

Mr. Vignesh, Finance Manager of KLM Ltd., Mumbai, furnishes the following particulars for the financial year 2012-13 :

- (i) *Salary ₹ 46,000 per month*
- (ii) *Value of medical facility in a hospital maintained by the company ₹ 7,000*
- (iii) *Rent free accommodation owned by the company*

- (iv) Housing loan of ₹ 6,00,000 given on 01.04.2012 at the interest rate of 6% p.a. (No repayment made during the year). The rate of interest charged by State Bank of India (SBI) as on 01.04.2012 in respect of housing loan is 10%.
- (v) Gifts in kind made by the company on the occasion of wedding anniversary of Mr. Vignesh ₹ 4,750.
- (vi) A wooden table and 4 chairs were provided to Mr. Vignesh at his residence (dining table). This was purchased on 1.5.2009 for ₹ 60,000 and sold to Mr. Vignesh on 1.8.2012 for ₹ 30,000.
- (vii) Personal purchases through credit card provided by the company amounting to ₹ 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 16.7.2009 for ₹ 2,50,000 was sold to the assessee on 14.7.2012 for ₹ 80,000.

Other income received by the assessee during the previous year 2012-13:

	Particulars	₹
(a)	Interest on Fixed Deposits with a company	5,000
(b)	Income from specified mutual fund	3,000
(c)	Interest on bank fixed deposits of a minor married daughter	3,000

- (ix) Contribution to LIC towards premium under section 80CCC ₹ 10,000
- (x) Deposit in PPF Account made during the year 2012-13 ₹ 70,000
- (xi) Bonds of ICICI (Tax savings) eligible for deduction under section 80C ₹ 30,000

Compute the taxable income of Mr. Vignesh and the tax thereon for the Assessment year 2013-14.

Answer

Computation of taxable income of Mr. Vignesh for the Assessment Year 2013-14

Particulars	₹
Income under the head "salaries"	
Salary [₹ 46,000 × 12]	5,52,000
Medical facility [in the hospital maintained by the company is exempt]	—
Rent free accommodation	
[Rule 3(1)] – 15% of salary is taxable	82,800
Use of dining table for 4 months	
[₹ 60,000 × 10 /100 × 4 /12]	2,000
Valuation of perquisite of interest on loan	

4.22 Income-tax

[Rule 3(7)(i)] – 10% is taxable which is to be reduced by actual rate of interest charged i.e. [10% - 6% = 4%]		24,000
Gift given on the occasion of wedding anniversary ₹ 4,750 is exempt, since its value is less than ₹ 5,000		-
Perquisite on sale of dining tables		
Cost	60,000	
Less: Depreciation on straight line method @ 10% for 3 years	<u>18,000</u>	
W.D.V	42,000	
Less: Amount paid by the assessee	<u>30,000</u>	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 16.7.2009 to 15.7.2010 @ 20%	<u>50,000</u>	
	2,00,000	
Less: Depreciation from 16.7.2010 to 15.7.2011 @ 20% on WDV	<u>40,000</u>	
Value as on 14.07.2012- being the date of sale to employee	1,60,000	
Less : Amount received from the assessee on 14.07.2012	<u>80,000</u>	<u>80,000</u>
Gross salary		<u>7,62,800</u>

Computation of taxable income

	Particulars	₹	₹
(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 on Fixed Deposit received by minor daughter (₹ 3,000 - ₹ 1500)	<u>1,500</u>	<u>6,500</u>
	Gross total income		<u>7,69,300</u>
	Less: Deductions under Chapter VI-A		
	Section 80C – PPF & ICICI bonds	1,00,000	
	Section 80CCC – LIC	<u>10,000</u>	
	Overall deduction limited to ₹ 1 lakh as per section 80 CCE		<u>1,00,000</u>
	Total Income		<u>6,69,300</u>

Tax on income	63,860
Add : Education cess @ 2%	1,277
Add : Secondary and Higher Education cess @ 1%	639
Total tax liability	65,776
Total tax liability (rounded off)	65,780

Note - 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 15.7.2012 where as the car was sold to the employee on 14.7.2012. The solution worked out above provides for wear and tear for only two years.

Question 15

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 31.03.2013:

- (i) Basic Salary ($\text{₹ } 50,000 \times 12$) = ₹ 6,00,000
- (ii) D.A. ($\text{₹ } 20,000 \times 12$) = ₹ 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. 2012-13 was ₹ 15.00 crores.
- (v) Contribution of the employer and employee to the recognized provident fund Account ₹ 3,00,000 each.
- (vi) Interest credited to Recognized Provident Fund Account at 9.5% - ₹ 60,000.
- (vii) Rent free unfurnished accommodation provided by the company for which the company pays a rent of ₹ 70,000 per annum.
- (viii) Entertainment Allowance – ₹ 30,000.
- (ix) Hostel allowance for three children – ₹ 5,000 each.

She makes the following payments and investments :

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

Determine the tax liability for the Assessment Year 2013-14.

4.24 Income-tax

Answer

Computation of Total Income of Mrs. Lakshmi for A.Y. 2013-14

Particulars	₹	₹
Income from salary		
Basic salary		6,00,000
Dearness allowance		2,40,000
Bonus		1,00,000
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 recognized provident fund 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 under section 80C		
Life insurance premium paid for insurance of major son	15,000	
Contribution to recognized provident fund	3,00,000	
Deduction under section 80CCC in respect of LIC pension fund	<u>12,000</u>	
	3,27,000	
Deduction limited to ₹ 1,00,000 as per section 80CCE		1,00,000
Deduction under section 80D		<u>12,000</u>
Total income before deduction under section 80G		12,67,000
Deduction under section 80G :		
50% of ₹ 1,26,700 (10% total income)(Refer Working Note 3)		<u>63,350</u>
Total income		12,03,650
Tax on total income		1,91,095
Add : Education cess @ 2%		3,822
Add : Secondary and higher education cess @ 1%		<u>1,911</u>
Total tax liability		<u>1,96,828</u>
Rounded off		1,96,830

Working Notes:**1. Value of rent free unfurnished accommodation**

Particulars	₹
Basic salary	6,00,000
Dearness allowance	2,40,000
Bonus	1,00,000
Commission @ 0.1% of turnover	1,50,000
Entertainment allowance	30,000
Children's hostel allowance	<u>7,800</u>
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 ₹ 9,90,000	<u>₹ 1,18,800</u>
	<u>₹ 1,81,200</u>

- 3.** As per amendment made by Finance Act, 2012, no deduction shall be allowed under section 80G in respect of any sum exceeding ₹ 10,000 unless such sum is paid by any mode other than cash. Here, since the donation of ₹ 2,00,000 is made by cheque, the same is allowed.

Question 16

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 1.4.2012 is ₹ 6,00,000. Mr. Badri pays ₹ 12,000 per month towards principal, on 5th of each month.*
- (ii) *Air-conditioners purchased 4 years back for ₹ 2,00,000 have been given to Mr. Badri for ₹ 90,000.*

Compute the chargeable perquisite in the hands of Mr. Badri for the A.Y. 2013-14.

The lending rate of State Bank of India as on 1.4.2012 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 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, 2012	5,88,000	1,960
May, 2012	5,76,000	1,920
June, 2012	5,64,000	1,880
July, 2012	5,52,000	1,840
August, 2012	5,40,000	1,800
September, 2012	5,28,000	1,760
October, 2012	5,16,000	1,720
November, 2012	5,04,000	1,680
December, 2012	4,92,000	1,640
January, 2013	4,80,000	1,600
February, 2013	4,68,000	1,560
March, 2013	4,56,000	<u>1,520</u>
Total value of this perquisite		<u>20,880</u>

Perquisite Value of Air Conditioners

Particulars	₹
Original cost	2,00,000
Depreciation on SLM basis for 4 years @10% i.e. ₹ 2,00,000 x 10% x 4	80,000
Written down value	1,20,000

Amount recovered from the employee	90,000
Perquisite value	30,000

Chargeable perquisite in the hands of Mr. Badri for the assessment year 2013-14

Particulars	₹
Housing loan	20,880
Air Conditioner	30,000
Total	50,880

Question 17

Mr. Narendra, who retired from the services of Hotel Samode Ltd., on 31.1.2013 after putting on service for 5 years, received the following amounts from the employer for the year ending on 31.3.2013:

- ◆ Salary @ ₹ 16,000 p.m. comprising of basic salary of ₹ 10,000, Dearness allowance of ₹ 3,000, City compensatory allowance of ₹ 2,000 and Night duty allowance of ₹ 1,000.
- ◆ Pension @ 30% of basic salary from 1.2.2013.
- ◆ Leave salary of ₹ 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 ₹ 50,000.

Compute the total income of Mr. Narendra for the assessment year 2013-14.

Answer

Computation of total income of Mr. Narendra for A.Y. 2013-14

Particulars	₹	₹
Income from Salaries		
Gross salary received during 1.4.2012 to 31.1.2013 @ ₹ 16,000 p.m. (₹ 16,000 x 10)		1,60,000
Pension for 2 months @ 30% of the basic salary of ₹ 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	₹
(i)	Statutory limit	3,00,000
(ii)	Cash equivalent of leave for 30 days for 5 years ($\text{₹ } 10,000 \times 150/30$)	50,000
(iii)	10 months average salary ($10 \times \text{₹ } 10,000$)	1,00,000
(iv)	Actual amount received	75,000

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

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

	Particulars	₹
(i)	Statutory limit	10,00,000
(ii)	Half month's salary for 5 years of service ($5 \times \text{₹ } 5,000$)	25,000
(iii)	Actual gratuity received	50,000

Therefore, ₹ 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 18

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 19

Mr. M is an area manager of M/s N. Steels Co. Ltd. During the financial year 2012-13, he gets the following emoluments from his employer:

Basic Salary	
Up to 31.8.2012	₹ 20,000 p.m.
From 1.9.2012	₹ 25,000 p.m.
Transport allowance	₹ 2,000 p.m.
Contribution to recognised provident fund	15% of basic salary
Children education allowance (Total)	₹ 500 p.m. for two children
City compensatory allowance	₹ 300 p.m.
Hostel expenses allowance (Total)	₹ 380 p.m. for two children
Tiffin allowance (actual expenses ₹ 3,700)	₹ 5,000 p.a.
Tax paid on employment	₹ 2,500

Compute taxable salary of Mr. M for the Assessment year 2013-14.

Answer**Computation of taxable salary of Mr. M. for the Assessment Year 2013-14**

Particulars	₹	₹
Basic Salary (₹ 20,000 x 5) +(₹ 25,000 x 7)		2,75,000
Transport allowance (₹ 2,000 x 12)	24,000	
Less : Exempt under section 10(14) (₹ 800 x 12)	<u>9,600</u>	14,400
Children education allowance (₹ 500 x 12)	6,000	
Less: Exempt under section 10(14) (₹ 100 x 2 x 12)	<u>2,400</u>	3,600
City Compensatory Allowance (₹ 300 x 12)		3,600
Hostel Expenses Allowance (₹ 380 x 12)	4,560	
Less: Exempt under section 10(14) (₹ 300 x 2 x 12 i.e. ₹ 7,200 but restricted to the actual allowance of ₹ 4,560)	<u>4,560</u>	Nil
Tiffin allowance (fully taxable)		5,000
Tax paid on employment [See Note Below]		2,500
Employer's contribution to recognized provident fund in excess of 12% of salary (i.e 3% of ₹ 2,75,000)		<u>8,250</u>
Gross Salary		3,12,350
Less : Tax on employment under section 16(iii)		<u>2,500</u>
Taxable salary		<u>3,09,850</u>

4.30 Income-tax

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 20

Mr. Ashok Kumar, an employee of a PSU, furnishes the following particulars for the previous year ending 31.3.2013:

Particulars		₹
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 2013-14.

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

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

Answer

Computation of Relief under section 89 for the Assessment Year 2013-14

Particulars	₹	₹
Salary Income for the year excluding the arrears		5,25,000
Add: Arrears relating to Financial Year 2006-07		<u>40,000</u>
Total Income		<u>5,65,000</u>
Assessment year 2013-14		
Tax on ₹ 5,65,000		
First ₹ 2,00,000 Nil	0	
Next ₹ 3,00,000 10%	30,000	
Balance <u>65,000</u> 20%	<u>13,000</u>	
<u>5,65,000</u>	43,000	
Add: Education cess @ 2%	860	
Secondary and higher education cess @1%	<u>430</u>	
Tax on total income (including arrears) (A)	<u>44,290</u>	

Total Income excluding arrears		5,25,000
Tax on ₹ 5,25,000		
First ₹ 2,00,000	Nil	Nil
Next ₹ 3,00,000	10%	30,000
Balance ₹ 25,000	20%	<u>5,000</u>
		35,000
		<u>5,25,000</u>
Add : Education cess @ 2%		700
Secondary and higher education cess @ 1%		<u>350</u>
Tax on total income (excluding arrears) (B)		<u>36,050</u>
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		<u>40,000</u>
Total income (including arrears)		1,80,000
Tax on ₹ 1,80,000		11,000
Add: Education Cess @ 2%		<u>220</u>
Tax on total income (including arrears) (C)		<u>11,220</u>
Total Income excluding arrears		1,40,000
Tax on ₹ 1,40,000		4,000
Add: Education Cess @ 2%		<u>80</u>
Tax on total income (excluding arrears) (D)		<u>4,080</u>
Difference between C & D II		7,140
Relief under section 89 (I – II)		1,100
Tax payable for A.Y. 2013-14 (₹ 44,290 – ₹ 1,100)		43,190

EXERCISES

- Where there is a decision to increase the D.A. in March, 2013 with retrospective effect from 1.4.2010, and the increased D.A. is received in April, 2013, the increase is taxable -
 - in the previous year 2012-13
 - in the previous year 2013-14
 - in the respective years to which they relate.
- The entertainment allowance received by a Government employee is exempt up to the lower of the actual entertainment allowance received, 1/5th of basic salary and -

4.32 Income-tax

- a) ₹4,000
 - b) ₹6,000
 - c) ₹5,000.
3. Rajesh is provided with a rent free unfurnished accommodation, which is owned by his employer, XY Pvt. Ltd., in New Delhi. The value of perquisite in the hands of Rajesh is -
- a) 20% of salary
 - b) 15% of salary
 - c) 10% of salary
4. Anirudh is provided with furniture to the value of ₹70,000 along with house from February, 2012. The actual hire charges paid by his employer are ₹5,000 p.a. The value of furniture to be included along with value of unfurnished house for A.Y.2013-14 is-
- a) ₹5,000
 - b) ₹7,000
 - c) ₹14,000
5. Employer's contribution to superannuation fund during the previous year 2012-13 is -
- a) subject to fringe benefits in the hands of the employer
 - b) fully taxable as perquisite in the hands of the employee
 - c) taxable as perquisite in the hands of the employee if it exceeds ₹1 lakh.
6. Write short notes on -
- a) Profits in lieu of salary
 - b) Specified employees
7. Is retrenchment compensation received by workmen taxable under the Act? If yes, to what extent is it taxable?
8. When is provision of medical facilities or assistance by an employer not treated as a perquisite in the hands of the employee? Discuss.
9. Can an assessee claim relief under section 89 in respect of VRS compensation of ₹6 lakh received by him from his employer, if he has claimed exemption of ₹5 lakh in respect of the same under section 10(10C)? Discuss.
10. Explain the term "Profit in lieu of salary".
11. Write short note on valuation of paid holidays for perquisite purposes under section 17(2).

Answers

1. a; 2. c; 3. b; 4. a; 5. c

UNIT 2 : Income From House Property

Question 1

Mr. Vaibhav own five houses at Coaching. Compute the gross annual value of each house from the information given below :

(₹)

	House -I	House -II	House -III	House -IV	House -V
Municipal value	1,20,000	2,40,000	1,10,000	90,000	75,000
Fair rent	1,50,000	2,40,000	1,14,000	84,000	80,000
Standard rent	1,08,000	N.A.	1,44,000	N.A.	78,000
Actual rent received / receivable	1,80,000	2,10,000	1,20,000	1,08,000	72,000

Answer

As per section 23(1) Gross Annual Value (GAV) is the higher of Annual letting Value (ALV) and actual rent received. ALV is higher of municipal value and fair rent but restricted to standard rent.

Computation of GAV of each house owned by Mr. Vaibhav

(₹)

	Particulars	House-I	House-II	House-III	House-IV	House-V
(i)	Municipal Value	1,20,000	2,40,000	1,10,000	90,000	75,000
(ii)	Fair rent	1,50,000	2,40,000	1,14,000	84,000	80,000
(iii)	Higher of (i) & (ii)	1,50,000	2,40,000	1,14,000	90,000	80,000
(iv)	Standard rent	1,08,000	N.A.	1,44,000	N.A.	78,000
(v)	ALV [Lower of (iii) & (iv)]	1,08,000	2,40,000	1,14,000	90,000	78,000
(vi)	Actual rent received/receivable	1,80,000	2,10,000	1,20,000	1,08,000	72,000
	GAV [Higher of (v) & (vi)]	1,80,000	2,40,000	1,20,000	1,08,000	78,000

Question 2

Explain the treatment of unrealized rent and its recovery in subsequent years under the provisions of Income-tax Act, 1961.

Answer

Unrealised rent refers to the rent payable but not paid by the tenant and which the owner is also not able to realize from the tenant. As per *Explanation* below section 23(1), the amount of rent which the owner cannot realize shall not be included in the actual rent while determining the annual value of the property, subject to fulfillment of following conditions prescribed under Rule 4 of the Income-tax Rules, 1962 :

- (a) the tenancy must be bonafide;
- (b) the defaulting tenant has vacated the property or steps have been taken to compel him to vacate the property;
- (c) the defaulting tenant does not occupy 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.

If the conditions mentioned above are satisfied, then, the actual rent should be reduced by the unrealized rent and thereafter, compared with the Annual Letting Value (being the higher of fair rent and municipal value, but restricted to standard rent) for computing the gross annual value.

As per section 25AA, the unrealised rent, when realised in any subsequent year, shall be deemed to be the income chargeable under the head 'Income from house property' in the previous year in which such rent is realised, whether or not the assessee is the owner of the property in that previous year.

Question 3

Explain briefly the applicability of section 22 for chargeability of income-tax for:

- (i) *House property situated in foreign country and*
- (ii) *House property with disputed ownership.*

Answer

Applicability of section 22 for chargeability of income-tax for –

(i) House property situated in foreign country

A resident assessee is taxable under section 22 in respect of annual value of a house property situated in foreign country. A resident but not ordinarily resident or a non resident is taxable in respect of income from such property if the income is received in India during the previous year. Once incidence of tax is attracted under section 22, the annual value will be computed as if the property is situated in India.

(ii) House property with disputed ownership

If the title of ownership of the house property is under dispute in a court of law, the decision about who is the owner lies with the Income tax Department. The assessment

cannot be held up for such dispute. Generally, a person who receives the income or who enjoys the possession of the house property as owner, though his claim is under dispute, is assessable to tax under section 22.

Question 4

Two brothers Arun and Bimal are co-owners of a house property with equal share. The property was constructed during the financial year 1998-1999. The property consists of eight identical units and is situated at Cochin.

During the financial year 2012-13, each co-owner occupied one unit for residence and the balance of six units were let out at a rent of ₹ 12,000 per month per unit. The municipal value of the house property is ₹ 9,00,000 and the municipal taxes are 20% of municipal value, which were paid during the year. The other expenses were as follows:

	₹
(i) Repairs	40,000
(ii) Insurance premium (paid)	15,000
(iii) Interest payable on loan taken for construction of house	3,00,000

One of the let out units remained vacant for four months during the year.

Arun could not occupy his unit for six months as he was transferred to Chennai. He does not own any other house.

The other income of Mr. Arun and Mr. Bimal are ₹ 2,90,000 and ₹ 1,80,000, respectively, for the financial year 2012-13.

Compute the income under the head 'Income from House Property' and the total income of two brothers for the assessment year 2013-14.

Answer

Computation of total income for the A.Y. 2013-14

Particulars	Arun (₹)	Bimal(₹)
Income from house property		
I. Self-occupied portion (25%)		
Annual value	Nil	Nil
Less: Deduction under section 24(b)		
Interest on loan taken for construction ₹ 75,000 (being 25% of ₹ 3 lakh) in total restricted to maximum of ₹ 30,000 for each co-owner since the property was constructed before 1.04.1999	30,000	30,000
Loss from self occupied property	(30,000)	(30,000)
II. Let-out portion (75%) – See Working Note below	<u>1,25,850</u>	<u>1,25,850</u>
Income from house property	95,850	95,850

4.36 Income-tax

Other Income	2,90,000	1,80,000
Total Income	3,85,850	2,75,850

Working Note – Computation of income from let-out portion of house property

Particulars	₹	₹
Let-out portion (75%)		
Gross Annual Value		
(a) Municipal value (75% of ₹ 9 lakh)	6,75,000	
(b) Actual rent [(₹ 12,000 x 6 x 12) – (₹ 12,000 x 1 x 4)]	8,16,000	
= ₹ 8,64,000 - ₹ 48,000		
- whichever is higher		8,16,000
Less: Municipal taxes 75% of 1,80,000 (20% of ₹ 9 lakh)		1,35,000
Net Annual Value (NAV)		6,81,000
Less: Deduction under section 24		
(a) 30% of NAV	2,04,300	
(b) Interest on loan taken for the house [75% of ₹ 3 lakh]	2,25,000	4,29,300
Income from let-out portion of house property		2,51,700
Share of each co-owner (50%)		1,25,850

Question 5

Mr. Raman is a co-owner of a house property along with his brother holding equal share in the property.

Particulars	₹
Municipal value of the property	1,60,000
Fair rent	1,50,000
Standard rent under the Rent Control Act	1,70,000
Rent received	15,000 p.m.

The loan for the construction of this property is jointly taken and the interest charged by the bank is ₹ 25,000, out of which ₹ 21,000 has been paid. Interest on the unpaid interest is ₹ 450. To repay this loan, Raman and his brother have taken a fresh loan and interest charged on this loan is ₹ 5,000.

The municipal taxes of ₹ 5,100 have been paid by the tenant.

Compute the income from this property chargeable in the hands of Mr. Raman for the A.Y. 2013-14.

Answer**Computation of income from house property of Shri Raman for A.Y. 2013-14**

Particulars	₹	₹
Gross Annual Value (See Note 1 below)		1,80,000
Less: Municipal taxes – paid by the tenant, hence not deductible		<u>Nil</u>
Net Annual Value (NAV)		1,80,000
Less: Deductions under section 24		
(i) 30% of NAV	54,000	
(ii) Interest on housing loan (See Note 2 below)		
- Interest on loan taken from bank	25,000	
- Interest on fresh loan to repay old loan for this property	<u>5,000</u>	<u>84,000</u>
Income from house property		<u>96,000</u>
50% share taxable in the hands of Shri Raman (See Note 3 below)		<u>48,000</u>

Notes:**1. Computation of Gross Annual Value (GAV)**

GAV is the higher of Annual Letting Value (ALV) and actual rent received. ALV is the higher of municipal value and fair rent, but restricted to standard rent.

Particulars	₹	₹	₹	₹
(a) Municipal value of property	1,60,000			
(b) Fair rent	1,50,000			
(c) Higher of (a) and (b)		1,60,000		
(d) Standard rent		1,70,000		
(e) Annual Letting Value [lower of (c) and (d)]			1,60,000	
(f) Actual rent [15,000 x 12]			1,80,000	
(g) Gross Annual Value [higher of (e) and (f)]				1,80,000

- Interest on housing loan is allowable as a deduction under section 24 on accrual basis. Further, interest on fresh loan taken to repay old loan is also allowable as deduction. However, interest on unpaid interest is not allowable as deduction under section 24.
- Section 26 provides that where a house property is owned by two or more persons whose shares are definite and ascertainable, the share of each such person in the income of house property, as computed in accordance with sections 22 to 25, shall be included in his respective total income. Therefore, 50% of the total income from the house property is taxable in the hands of Mr. Raman since he is an equal owner of the property.

Question 6

Mrs. Rohini Ravi, a citizen of the U.S.A., is a resident and ordinarily resident in India during the financial year 2012-13. 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 ₹45.

She took ownership and possession of a flat in Chennai on 1.7.2012, 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 31.3.2013. The municipal valuation is ₹32,000 p.m. and the fair rent is ₹4,20,000 p.a. She paid the following to Corporation of Chennai :

Property Tax	₹16,200
Sewerage Tax	₹1,800

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

	₹
Period prior to 1.4.2012	49,200
1.4.2012 to 30.6.2012	50,800
1.7.2012 to 31.3.2013	1,31,300

She had a house property in Bangalore, which was sold in March, 2010. In respect of this house, she received arrears of rent of ₹60,000 in March, 2013. This amount has not been charged to tax earlier.

Compute the income chargeable from house property of Mrs. Rohini Ravi for the assessment year 2013-14, 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 ₹9,00,000 and the Chennai flat is ₹3,15,000. Since the annual value of Los Angeles house is obviously more, it will be 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	₹	₹
1.	Self-occupied house at Los Angeles		
	Annual value	Nil	
	Less: Deduction under section 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) [4,20,000 x 9/12]		3,15,000
	Less: Municipal Taxes (Property tax + Sewerage tax)		<u>18,000</u>
	Net Annual Value (NAV)		2,97,000
	Less: Deductions under section 24		
	30% of NAV	89,100	
	Interest on borrowed capital (See Note below)	<u>1,91,940</u>	<u>2,81,040</u>
			15,960
3.	Arrears in respect of Bangalore property		
	Arrears of rent received	60,000	
	Less: Deduction @ 30%	<u>18,000</u>	<u>42,000</u>
	Income chargeable under the head "Income from house property"		<u>57,960</u>

Note : Interest on borrowed capital	₹
Interest for the current year (₹ 50,800 + ₹ 1,31,300)	1,82,100
Add: 1/5th of pre-construction interest (₹ 49,200 x 1/5)	<u>9,840</u>
Interest deduction allowable under section 24	<u>1,91,940</u>

Question 7

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:

- 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) A person who acquires any rights (excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof, by virtue of any such transaction as is referred to in section 269UA(f).

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.

Question 8

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 1-04-2011 and completed on 1-04-2012. B started the construction on 1-04-2011 and completed the construction on 30-06-2012. A occupied the entire house on 01-04-2012. B occupied the ground floor on 01-07-2012 and let out the first floor for a rent of ₹ 15,000 per month. However, the tenant vacated the house on 31-12-2012 and B occupied the entire house during the period 01-01-2013 to 31-03-2013.

Following are the other information

- | | | |
|-------|---|----------------------------|
| (i) | Fair rental value of each unit
(ground floor /first floor) | ₹1,00,000 per annum |
| (ii) | Municipal value of each unit
(ground floor / first floor) | ₹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 ₹ 20 lakhs @ 12% p.a. on 01-04-2011. B has availed a housing loan of ₹12 lakhs @ 10% p.a. on 01-07-2011. No repayment was made by either of

them till 31-03-2013. Compute income from house property for A and B for the previous year 2012-13 (A.Y. 2013-14).

Answer

Computation of income from house property of Mr. A for A.Y. 2013-14

Particulars	₹	₹
Annual value is nil (since house is self occupied)		Nil
Less : Deduction under section 24(b)		
Interest paid on borrowed capital ₹ 20,00,000 @ 12%	2,40,000	
Pre-construction interest ₹ 2,40,000 / 5	<u>48,000</u>	
	2,88,000	
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>

Computation of income from house property of Mr. B for A.Y. 2013-14

Particulars	Ground floor (Self occupied)	First floor
Gross annual value (See note below)	Nil	90,000
Less :Municipal taxes (for first floor)		<u>4,000</u>
Net annual value (A)	Nil	86,000
Less : Deduction under section 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 = ₹ 18,000 per annum	<u>9,000</u>	<u>9,000</u>
Total deduction under section 24 (B)	<u>69,000</u>	<u>94,800</u>
Income from house property (A)-(B)	<u>(69,000)</u>	<u>(8,800)</u>
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 30.6.2012.

Annual letting value = ₹ 75,000 being higher of -

Fair rent = $1,00,000 \times 9/12 = ₹ 75,000$

Municipal value = $72,000 \times 9/12 = ₹ 54,000$

Actual rent = ₹ 90,000 (₹ 15,000 p.m. for 6 months from July to December, 2012)

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

Question 9

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 10

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 prerequisite 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 11

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 12

Mr. Kalpesh borrowed a sum of ₹ 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, 2013, repayments towards principal and interest had been made during the year ended 31.3.2013.

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 2013-14;*
- (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

- (i) Interest on borrowed capital is allowed as deduction under section 24(b)**

As per 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. 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, 2013. Hence, deduction in respect of interest on housing loan cannot be claimed in the assessment year 2013-14.

- (ii) 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 2013-14, there is no such income chargeable under this head. Hence, deduction under section 80C cannot be claimed for A.Y. 2013-14.

Question 13

Mr. X owns one residential house in Mumbai. The house is having two identical units. First unit of the house is self occupied by Mr. X and another unit is rented for ₹ 8,000 p.m. The rented unit was vacant for 2 months during the year. The particulars of the house for the previous year 2012-13 are as under:

Standard rent	₹ 1,62,000 p.a.
Municipal valuation	₹ 1,90,000 p.a.
Fair rent	₹ 1,85,000 p. a
Municipal tax (Paid by Mr. X)	15% of municipal valuation
Light and water charges	₹ 500 p.m.
Interest on borrowed capital	₹ 1,500 p.m.
Lease money	₹ 1,200 p.a.
Insurance charges	₹ 3,000 p.a.
Repairs	₹ 12,000 p.a.
Compute income from house property of Mr. X for the A.Y. 2013-14.	

Answer

Computation of Income from house property for A.Y. 2013-14

Particulars	₹	₹
(A) Rented unit (50% of total area – See Note 1 below)		
Step I - Computation of Annual letting Value		
Municipal valuation (₹ 1,90,000 x ½)	95,000	

Fair rent (₹ 1,85,000 x ½)	92,500	
Standard rent (₹ 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 (₹ 8,000 x 12)	96,000	
Step III – Computation of Gross Annual Value		
Actual rent received owing to vacancy (₹ 96,000 – ₹ 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 ₹ 95,000)		<u>14,250</u>
Net Annual value		65,750
Less : Deductions under section 24 -		
(i) 30% of net annual value	19,725	
(ii) Interest on borrowed capital (₹ 750 x 12)	<u>9,000</u>	<u>28,725</u>
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 (₹ 750 x 12)	<u>9,000</u>	<u>9,000</u>
Income from house property		<u>28,025</u>

Note: No deduction will be allowed separately for light and water charges, lease money paid, insurance charges and repairs.

Question 14

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 2012-13. 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 ₹ 10,000. Standard rent for each floor is ₹ 11,000 per month and fair rent is ₹ 10,000 per month. Municipal taxes paid for the house amounts to ₹ 7,500. Mrs. Indu had constructed the house by taking a loan from a nationalised bank on 20.6.2007. She repaid the loan of ₹ 54,000 including interest of ₹ 24,000. The value of one dollar is to be taken as ₹ 45.

Compute total income from house property of Mrs. Indu.

Answer

Computation of Income from House Property of Mrs. Indu for the A.Y. 2013-14

Particulars	₹	₹
House property in USA		
GAV– Rent received {treated as fair rent} (\$2000 p.m. x ₹ 45 per USD x 12 months)	10,80,000	
Less : Municipal taxes paid (\$1500 x ₹ 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
House property in Mumbai (Let- out portion - First Floor)		
Annual Letting Value (lower of standard rent and fair rent)		
Standard Rent (₹ 11,000 x 12)	₹ 1,32,000	
Fair rent (₹ 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 ₹ 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 ₹ 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 ₹ 24,000)	12,000	(-) 12,000
Income from house property		7,66,125

Question 15

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

Answer

- (a) ₹ 30,000 per annum

EXERCISES

1. Ganesh is a member of a house building co-operative society. The society is the owner of the flats constructed by it. One of the flats is allotted to Ganesh. The income from that flat will be assessed in the hands of
 - a) Co-operative Society
 - b) Ganesh
 - c) Neither of the above.
2. Vacant site lease rent is taxable as
 - a) Income from house property
 - b) Business income
 - c) Income from other sources or business income, as the case may be
3. Treatment of unrealized rent for determining income from house property
 - a) To be deducted from annual letting value
 - b) To be deducted from actual rent
 - c) To be deducted under section 24 from annual value
4. Municipal taxes to be deducted from GAV should be
 - a) Paid by the tenant during the previous year
 - b) Paid by the owner during the previous year
 - c) Accrued during the previous year

5. *Deduction under section 24(a) is*
 - a) *1/3rd of NAV*
 - b) *repairs actually incurred by the owner*
 - c) *30% of NAV*
6. *Interest on borrowed capital accrued up to the end of the previous year prior to the year of completion of construction is allowed*
 - a) *as a deduction in the year of completion of construction*
 - b) *in 5 equal annual installments from the year of completion of construction*
 - c) *In the respective year in which the interest accrues*
7. *The ceiling limit of deduction under section 24(b) in respect of interest on loan taken on 1.4.10 for repairs of a self-occupied house is*
 - a) *₹ 30,000 p.a.*
 - b) *₹ 1,50,000 p.a.*
 - c) *No limit*
8. *Where an assessee has two house properties for self-occupation, the benefit of nil annual value will be available in respect of -*
 - a) *Both the properties*
 - b) *The property which has been acquired/constructed first*
 - c) *Any one of the properties, at the option of the assessee*
9. *Leena received ₹ 30,000 as arrears of rent during the P.Y. 2012-13. The amount taxable under section 25B would be -*
 - a) *30,000*
 - b) *21,000*
 - c) *20,000*
10. *Vidya received ₹ 90,000 in May, 2012 towards recovery of unrealised rent, which was deducted from actual rent during the P.Y. 2011-12 for determining annual value. The amount taxable under section 25AA for A.Y.2013-14 would be -*
 - a) *90,000*
 - b) *63,000*
 - c) *60,000*
11. *Ganesh and Rajesh are co-owners of a self-occupied property. They own 50% share each. The interest paid by each co-owner during the previous year on loan (taken for acquisition of property during the year 2003) is ₹ 1,62,000. The amount of allowable deduction in respect of each co-*

owner is –

- a) 1,62,000
- b) 75,000
- c) 1,50,000

12. An assessee, who was deriving income from house property, realised a sum of ₹ 52,000 on account of display of advertisement hoardings of various concerns on the roof of the building. He claims that this amount should be considered under the head "Income from house property" and not "Income from other sources". How do you deal with the following issue under the provisions of the Income-tax Act, 1961?
13. Ram owned a house property at Chennai which was occupied by him for the purpose of his residence. He was transferred to Mumbai in June, 2012 and therefore, he let out the property w.e.f. 1.7.2012 on a monthly rent of ₹ 8,000. The corporation tax payable in respect of the property was ₹ 2,000 of which 50% was paid by him before 31.3.2013. Interest on money borrowed for the construction of the property amounted to ₹ 12,000. Compute the income from house property for the A.Y.2013-14.
14. What do you understand by "Composite Rent"? What is the tax treatment of Composite Rent under the Income-tax Act, 1961?

Answers

1. b; 2. c; 3. b; 4. b; 5. c; 6. b; 7. a; 8. c; 9. b; 10. a; 11. C, 13. ₹ 37,700

UNIT 3 : Profits and Gains of Business or Profession

Question 1

A car purchased by Dr. Soman on 10.08.2010 for ₹ 5,25,000 for personal use is brought into professional use on 1.07.2012 by him, when its market value was ₹ 2,50,000.

Compute the actual cost of the car and the amount of depreciation for the assessment year 2013-14 assuming the rate of depreciation to be 15%.

Answer

As per section 43(1), the expression "actual cost" would mean the actual cost of asset to the assessee.

The purchase price of ₹ 5,25,000 is, therefore, the actual cost of the car to Dr. Soman. Market value (i.e. ₹ 2,50,000) on the date when the asset is brought into professional use is not relevant.

Therefore, amount of depreciation on car as per section 32 for the A.Y.2013-14 would be ₹ 78,750, being ₹ 5,25,000 x 15%.

Note- Explanation 5 to section 43(1) providing for reduction of notional depreciation from the date of acquisition of asset for personal use to determine actual cost of the asset is applicable only in case of building which is initially acquired for personal use and later brought into professional use. It is not applicable in respect of other assets.

Question 2

MNP Ltd. commenced operations of the business of a new four-star hotel in Chennai on 1.4.2012. The company incurred capital expenditure of ₹ 40 lakh during the period January, 2012 to March, 2012 exclusively for the above business, and capitalized the same in its books of account as on 1st April, 2012. Further, during the previous year 2012-13, it incurred capital expenditure of ₹ 2.5 crore (out of which ₹ 1 crore was for acquisition of land) exclusively for the above business. Compute the income under the head "Profits and gains of business or profession" for the assessment year 2013-14, assuming that MNP Ltd. has fulfilled all the conditions specified for claim of deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading "C. – Deductions in respect of certain incomes". The profits from the business of running this hotel (before claiming deducting under section 35AD) for the assessment year 2013-14 is ₹ 80 lakhs. Assume that the company also has another existing business of running a four-star hotel in Kanpur, which commenced operations 5 years back, the profits from which was ₹ 130 lakhs for assessment year 2013-14.

Would MNO Ltd. be entitled to deduction under section 35AD if it transfers the operation of the hotel in Chennai to PQR Ltd, while continuing to own the said hotel?

Answer

Computation of income under the head “Profit and gains of business or profession” of MNP Ltd. for A.Y. 2013-14

Particulars	₹ (in lakh)	₹ (in lakh)
Profits from the specified business of new four-star hotel in Chennai (before providing deduction under section 35AD)		80
Less: Deduction under section 35AD		
Capital expenditure incurred during the P.Y. 2012-13 (excluding the expenditure incurred on acquisition of land) = ₹ 250 lakh – ₹ 100 lakh (See Notes 1 & 2 below)	150	
Capital expenditure incurred during January 2012 to March 2012 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2012 (See Note 3 below)	<u>40</u>	
Total deduction under section 35AD for A.Y.2013-14		<u>190</u>
Income from the specified business of new hotel in Chennai		(110)
Profit from the existing business of running a four-star hotel in Kanpur (See Note 4 below)		<u>130</u>
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A		<u><u>20</u></u>

Notes:

- (1) According to the provisions of section 35AD, an assessee shall be allowed a deduction in respect of 100% of the capital expenditure incurred wholly and exclusively for the purpose of the specified business which, *inter alia*, includes the business in the nature of building and operating a new hotel of two-star or above category, anywhere in India. Therefore, the newly commenced four-star hotel business of MNP Ltd qualifies for deduction under section 35AD, since it has fulfilled all the conditions for claim of deduction under that section.
- (2) The expenditure on acquisition of land, however, does not qualify for deduction under section 35AD.
- (3) The capital expenditure incurred prior to commencement of specified business shall be allowed as deduction under section 35AD(1) in the year of commencement of specified business, if the same is capitalized in the books of accounts of the assessee on the date of commencement of its operations. Therefore, the expenditure of ₹ 40 lakh is allowable

as deduction in A.Y. 2013-14, since it has been capitalized in the books of accounts of MNP Ltd. as on 1.4.2012.

- (4) As per section 73A, the loss computed under section 35AD in respect of a specified business can be set off against the profit of another specified business. Building and operating a hotel of two-star and above category, anywhere in India, is a specified business, therefore, the loss from the business of new four-star hotel in Chennai can be set-off against the income of the existing four-star hotel in Kanpur.

Section 35AD(6A) provides that where the assessee, MNO Ltd., builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation of the said hotel to another person, the assessee shall be deemed to be carrying on the specified business of building and operating a hotel. Therefore, in this case, MNO Ltd. would be eligible to claim investment linked deduction under section 35AD even if it transfers the operation of the Chennai hotel to PQR Ltd.

Question 3

Mr. Asim, a 60 year old individual, engaged in the business of roasting and grounding of coffee, derives income of ₹ 10 lacs during the financial year 2012-13. Compute the tax payable by him assuming he has not earned any other income during the financial year 2012-13. What would be your answer if Mr. Asim is also engaged in the business of growing and curing coffee?

Answer

If Mr. Asim is engaged only in the business of roasting and grounding of coffee (and not growing and curing of coffee), his entire income of ₹ 10 lakhs would be treated as business income and his tax liability would be ₹ 1,28,750 (₹ 1,25,000+₹ 2,500+₹ 1,250).

If Mr. Asim is also engaged in the business of growing and curing of coffee, in addition to roasting and grounding of coffee, the provisions of Rule 7B of the Income-tax Rules, 1962 would apply. As per Rule 7B, where income is derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, 40% of such income shall be treated as business income and the balance as agricultural income.

Therefore, in such a case, the business income would be 40% of ₹ 10,00,000 = ₹ 4,00,000

Calculation of tax liability for A.Y 2013-14

Particulars	₹
Tax on ₹ 10,00,000 [being the aggregate of non-agricultural income (i.e. ₹ 4,00,000) and agricultural income (i.e. ₹ 6,00,000)]	1,25,000
Less: Tax on ₹ 8,50,000 [being aggregate of agricultural income (i.e. ₹	

6,00,000) and basic exemption limit (i.e. ₹2,50,000)]	95,000
	30,000
Add: Education cess @ 2%	600
Secondary and higher education cess @ 1%	300
Total tax liability	30,900

Question 4

State with reasons the allowability of the following expenses under the Income-tax Act, 1961 while computing income from business or profession for the Assessment Year 2013-14 :

- (i) Provision made on the basis of actuarial valuation for payment of gratuity ₹ 5,00,000. However, no payment on account of gratuity was made before due date of filing return.
- (ii) Purchase of oil seeds of ₹50,000 in cash from a farmer on a banking day.
- (iii) Tax on non-monetary perquisite provided to an employee ₹ 20,000.
- (iv) Payment of ₹50,000 by using credit card for fire insurance.
- (v) Salary payment of ₹ 2,00,000 outside India by a company without deduction of tax.
- (vi) Sales tax deposited in cash ₹ 50,000 with State Bank of India.
- (vii) Payment made in cash ₹ 30,000 to a transporter in a day for carriage of goods

Answer**(i) Not allowable as deduction**

As per section 40A(7), no deduction is allowed in computing business income in respect of any provision made by the assessee in his books of account for the payment of gratuity to his employees except in the following two cases:

- (1) where any provision is made for the purpose of payment of sum by way of contribution towards an approved gratuity fund or;
- (2) where any provision is made for the purpose of making any payment on account of gratuity that has become payable during the previous year.

Therefore, in the present case, the provision made on the basis of actuarial valuation for payment of gratuity has to be disallowed under section 40A(7), since, no payment has been actually made on account of gratuity.

Note: It is assumed that such provision is not for the purpose of contribution towards an approved gratuity fund.

(ii) Allowable as deduction

As per Rule 6DD, in case the payment is made for purchase of agricultural produce directly to the cultivator, grower or producer of such agricultural produce, no

disallowance under section 40A(3) is attracted even though the cash payment for the expense exceeds ₹ 20,000.

Therefore, in the given case, disallowance under section 40A(3) is not attracted since, cash payment for purchase of oil seeds is made directly to the farmer.

(iii) Not allowable as deduction

As per section 40(a)(v), income-tax of ₹ 20,000 paid by the employer in respect of non-monetary perquisites provided to its employees, which is exempt in the hands of the employee under section 10(10CC), is not deductible while computing business income.

(iv) Allowable as deduction

Payment for fire insurance is allowable as deduction under section 36(1). Since payment by credit card is covered under Rule 6DD, which contains the exceptions to section 40A(3), disallowance under section 40A(3) is not attracted in this case.

(v) Not allowable as deduction

Disallowance under section 40(a)(iii) is attracted in respect of salary payment of ₹ 2,00,000 outside India by a company without deduction of tax at source.

(vi) Allowable as deduction

As per Rule 6DD, if the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender, no disallowance under section 40A(3) is attracted even though the cash payment for the expense exceeds ₹ 20,000.

Therefore, in the given case, no disallowance under section 40A(3) is attracted since payment of sales tax is covered by the above mentioned exception contained in Rule 6DD.

(vii) Allowable as deduction

The limit for attracting disallowance under section 40A(3) for payment otherwise than by way of account payee cheque or account payee bank draft is ₹ 35,000 in case of payment made for plying, hiring or leasing goods carriage. Therefore, in the present case, disallowance under section 40A(3) is not attracted for payment of ₹ 30,000 made in cash to a transporter for carriage of goods.

Question 5

Mr. Gupta is having a trading business and his Trading and Profit & Loss Account for the financial year 2012-13 is as under:

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening stock	1,00,000	By Sales	70,00,000
To Purchase	49,00,000	By Closing stock	50,000

To Gross profit	<u>20,50,000</u>		
Total	<u>70,50,000</u>	Total	<u>70,50,000</u>
Salary to employees (Including Contribution to PF)	5,00,000	By Gross Profit b/d	20,50,000
Donation to Prime Minister Relief Fund	1,00,000		
Provision for bad debts	50,000		
Bonus to employees	50,000		
Interest on bank loan	50,000		
Family planning expenditure incurred on employees	20,000		
Depreciation	30,000		
Income-tax	1,00,000		
To Net profit	<u>11,50,000</u>		
Total	<u>20,50,000</u>	Total	<u>20,50,000</u>

Other information:

- (i) Depreciation allowable ₹40,000 as per Income-tax Rules, 1962.
- (ii) No deduction of tax at source on payment of interest on bank loan has been made.
- (iii) Payment of bonus to workers made in the month of October, 2012 on the occasion of Diwali festival.
- (iv) Out of salary, ₹25,000 pertains to his contributions to recognized provident fund which was deposited after the due date of filing return of income. Further, employees contribution of ₹25,000 was also deposited after the due date of filing return of income.

Calculate gross total income of Mr. Gupta for the Assessment Year 2013-14.

Answer

Computation of Gross Total Income of Mr. Gupta for the A.Y. 2013-14

Particulars	₹	₹
Income from Business or profession		
Net profit as per Profit and Loss Account		11,50,000
Add : Expenses not deductible		
Donation to Prime Minister Relief Fund (Refer Note -1)	1,00,000	
Provision for bad debts (Refer Note-2)	50,000	
Family planning expenditure incurred on employees	20,000	

4.56 Income-tax

(Refer Note -3)		
Depreciation as per Profit and Loss Account	30,000	
Income-tax (Refer Note -4)	1,00,000	
Employer's contribution to recognized provident fund (Note-5)	<u>25,000</u>	<u>3,25,000</u>
		14,75,000
Less : Expense allowed		
Depreciation as per Income- tax Rules, 1962		<u>40,000</u>
		14,35,000
Add : Employee's contribution included in income as per Section 2(24)(x) (Refer Note-6)		<u>25,000</u>
Business Income / Gross Total Income		<u>14,60,000</u>

Notes:-

- (1) Donation to Prime Minister Relief Fund is not allowed as deduction from the business income. It is allowed as deduction under section 80G from the gross total income.
- (2) Provisions for bad debts is allowable as deduction under section 36(1)(viiia) (subject to the limits specified therein) only in case of banks, public financial institutions, State Financial Corporation and State Industrial Investment Corporation. Therefore, it is not allowable as deduction in the case of Mr. Gupta.
- (3) Expenditure on family planning is allowed as deduction under section 36(1)(ix) only to a company assessee. Therefore, such expenditure is not allowable as deduction in the hands of Mr. Gupta.
- (4) Income-tax paid is not allowed as deduction as per the provisions of section 40(a)(ii).
- (5) Since, Mr. Gupta's contribution to recognized provident fund is deposited after the due date of filing return of income, the same is disallowed as per provisions of section 43B.
- (6) Employee's contribution is includible in the income of the employer by virtue of Section 2(24)(x). The deduction for the same is not provided for as it was deposited after the due date. It has been assumed that it has not been already debited in the given profit and loss account.
- (7) TDS provisions under section 194A are not attracted in respect of payment of interest on bank loan. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.
- (8) Since, the payment of bonus is made in October 2012, hence, no disallowance is attracted.

Question 6

M/s. Dollar Ltd., a manufacturing concern, furnishes the following particulars:

		₹
(i)	Opening writing down value under Income-tax of block plant and machinery	5,00,000
(ii)	Purchase of plant and machinery (put to use before 01.10.2012)	2,00,000
(iii)	Sale proceeds of plant and machinery which became obsolete- the plant and machinery was purchased on 01-04-2010 for ₹ 5,00,000.	5,000

Further, out of purchase of plant and machinery:

- (a) Plant and machinery of ₹ 20,000 has been installed in office.
- (b) Plant and machinery of ₹ 20,000 was used previously for the purpose of business by the seller.

Compute depreciation and additional depreciation as per Income-tax Act, 1961 for the Assessment Year 2013-14.

Answer

Computation of written down value of Plant and Machinery of M/s. Dollar Ltd. for the A.Y. 2013-14:

Particulars	₹
Opening written down value (as on 01.04.2012)	5,00,000
Add: Purchase of plant and machinery during the previous year	<u>2,00,000</u>
	7,00,000
Less: Sale proceeds of obsolete plant and machinery sold during the year	<u>5,000</u>
Closing Written down value (as on 31.03.2013)	<u>6,95,000</u>

Computation of Depreciation and Additional Depreciation for A.Y. 2013-14 as per Section 32 of the Income-tax Act, 1961

Particulars	₹
Normal Depreciation (₹ 6,95,000 x 15%)	1,04,250
Additional Depreciation (Refer Note 2) (₹ 2,00,000 – ₹ 20,000 - ₹ 20,000) x 20%	<u>32,000</u>
Depreciation on Plant and Machinery	<u>1,36,250</u>

Notes:-

- (1) Since the new plant and machinery was purchased and put to use before 1.10.2012, it was put to use for more than 180 days in the year. Hence, full depreciation is allowable for A.Y. 2013-14.
- (2) As per section 32(1)(ia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, *inter*

alia, in the business of manufacture or production of any article or thing, at the rate of 20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, *inter alia*, –

- (i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;
- (ii) any machinery or plant installed in office premises, residential accommodation or in any guest house.

In view of the above provisions, additional depreciation cannot be claimed in respect of –

- (i) Plant and machinery of ₹ 20,000 used previously for the purpose of business by the seller.
- (ii) Plant and machinery of ₹ 20,000, installed in office.

Therefore, in the given case additional depreciation has to be provided only on ₹ 1,60,000 (i.e. ₹ 2,00,000 - ₹ 40,000).

Question 7

Rao & Jain, a partnership firm consisting of two partners, reports a net profit of ₹ 7,00,000 before deduction of the following items:

- (1) *Salary of ₹ 20,000 each per month payable to two working partners of the firm (as authorized by the deed of partnership).*
- (2) *Depreciation on plant and machinery under section 32 (computed) ₹ 1,50,000.*
- (3) *Interest on capital at 15% per annum (as per the deed of partnership). The amount of capital eligible for interest ₹ 5,00,000.*

Compute:

- (i) *Book-profit of the firm under section 40(b) of the Income-tax Act, 1961.*
- (ii) *Allowable working partner salary for the assessment year 2013-14 as per section 40(b) of the Income-tax Act, 1961.*

Answer

- (i) As per the provisions of *Explanation 3* to section 40(b), book profit shall mean the net profit as per the profit and loss account for the relevant previous year computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to the partners of the firm if the same has been already deducted while computing the net profit.

In the present case, the net profit given is before deduction of depreciation on plant and machinery, interest on capital of partners and salary to the working partners. Therefore, the book profits shall be as follows:

**Computation of Book Profit of the firm under section 40(b) of the
Income-tax Act, 1961.**

Particulars	₹	₹
Net Profit (before deduction of depreciation, salary and interest)		7,00,000
Less: Depreciation under section 32	1,50,000	
Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (5,00,000 × 12%)	<u>60,000</u>	<u>2,10,000</u>
Book Profit		<u>4,90,000</u>

- (ii) Salary actually paid to working partners = ₹ 20,000 × 2 × 12 = ₹ 4,80,000.

As per the provisions of section 40(b)(v), the salary paid to the working partners is allowed subject to the following limits -

On the first ₹ 3,00,000 of book profit	₹ 1,50,000 or 90% of book profit, whichever is more
On the balance of book profit	60% of the balance book profit

Therefore, the maximum allowable working partners' salary for the A.Y. 2013-14 in this case would be:

Particulars	₹
On the first ₹ 3,00,000 of book profit [(₹ 1,50,000 or 90% of ₹ 3,00,000) whichever is more]	2,70,000
On the balance of book profit [60% of (₹ 4,90,000 - ₹ 3,00,000)]	<u>1,14,000</u>
Maximum allowable partners' salary	<u>3,84,000</u>

Hence, allowable working partners' salary for the A.Y. 2013-14 as per the provisions of section 40(b)(v) is ₹ 3,84,000.

Question 8

Ramji Ltd., engaged in manufacture of medicines (pharmaceuticals), furnishes the following information for the year ended 31.03.2013:

- (i) *Municipal tax relating to office building ₹ 51,000 not paid till 30.09.2013.*
- (ii) *Patent acquired for ₹ 20,00,000 on 01.09.2012 and used from the same month.*
- (iii) *Capital expenditure on scientific research ₹ 10,00,000 which includes cost of land ₹ 2,00,000.*
- (iv) *Amount due from customer X outstanding for more than 3 years written off as bad debt in the books ₹ 5,00,000.*
- (v) *Income tax paid ₹ 90,000 by the company in respect of non-monetary perquisites*

provided to its employees.

- (vi) *Provident fund contribution of employees ₹ 5,50,000 remitted in July, 2013.*
- (vii) *Expenditure towards advertisement in souvenir of a political party ₹ 1,50,000.*
- (viii) *Refund of sales tax ₹ 75,000 received during the year, which was claimed as expenditure in an earlier year.*

State with reasons the taxability or deductibility of the items given above under the Income-tax Act, 1961.

Note: *Computation of total income is not required.*

Answer

- (i) As per section 43B, municipal tax is not deductible for A.Y. 2013-14 since it is not paid on or before 30.09.2013, being the due date of filing the return for A.Y. 2013-14.

Note – It is assumed that the company has not undertaken any international transaction during the year, and therefore does not have to file a transfer pricing report under section 92E. Therefore, the due date of filing of return of the company would be 30th September, 2013.

- (ii) Patent is an intangible asset eligible for depreciation@25%. Since it has been acquired and put to use for more than 180 days during the previous year 2012-13, full depreciation of ₹ 5,00,000 (i.e. 25% of ₹ 20,00,000) is allowable as deduction under section 32.
- (iii) Weighted deduction@200% is available under section 35(2AB) in respect of expenditure incurred by a company on scientific research on in-house research and development facility as approved by the prescribed authority. However, cost of land is not eligible for deduction.

Deduction under section 35(2AB) = 200% of ₹ 8 lakhs = ₹ 16,00,000.

Note: It is presumed that the in-house research and development facility is approved by the prescribed authority and is hence, eligible for the weighted deducted@200% under section 35(2AB). It may be noted that the benefit of weighted deduction under section 35(2AB) has been extended to expenditure incurred upto 31.03.2017 by the Finance Act, 2012. Prior to the amendment, the deduction was restricted to expenditure incurred upto 31.03.2012.

- (iv) Bad debts i.e. ₹ 5,00,000 written off in the books of account as irrecoverable is deductible under section 36(1)(vii), provided the debt has been taken into account in computing the income of the company in the current previous year or any of the earlier previous years.
- (v) As per section 40(a)(v), income-tax of ₹ 90,000 paid by the company in respect of non-monetary perquisites provided to its employees, exempt in the employee's hands under section 10(10CC), is not deductible while computing business income of the employer-company.

- (vi) The employees' contribution to provident fund is taxable in the hands of the company since it is included in the definition of income under section 2(24)(x).

As per section 36(1)(va), provident fund contribution of employees is deductible only if such sum is credited to the employee's provident fund account on or before the due date under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952. In this case, since it is remitted after the due date under the said Act, it is not deductible.

Note: There is an alternate view that remittance of provident fund contribution of employees is deductible even though it is remitted beyond the due date under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952, in case the same is remitted before the due date of filing return of income in view of the Delhi High Court decision in *CIT vs. Aimil Ltd.* (2010) 321 ITR 508.

- (vii) Expenditure towards advertisement in souvenir of a political party is disallowed under section 37(2B) while computing business income.

However, the same is deductible under section 80GGB from gross total income.

- (viii) Refund of a trading liability is taxable under section 41(1), if a deduction was allowed in respect of the same to the taxpayer in an earlier year.

Since sales tax was claimed as expenditure in an earlier year, refund of the same during the year would attract the provisions of section 41(1).

Question 9

State the specified businesses eligible for weighted deduction under section 35AD of the Income-tax Act, 1961.

Answer

The following are the specified business eligible for weighted deduction @ 150% of the capital expenditure under section 35AD(1A), if they commence operations on or after 1.04.2012 -

- (1) setting up and operating cold chain facilities for specified products.
- (2) setting up and operating warehousing facilities for storing agricultural produce.
- (3) building and operating a hospital, anywhere in India, with atleast 100 beds for patients.
- (4) developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the CBDT in accordance with the prescribed guidelines.
- (5) production of fertilizer in India.

Question 10

During the financial year 2012-13, the following payments/expenditure were made/incurred by Mr. Yuvan Raja, a resident individual (whose turnover during the year ended 31.3.2012 was ₹59 lacs) :

- (i) Interest of ₹ 12,000 was paid to Rehman & Co., a resident partnership firm, without deduction of tax at source;
- (ii) Interest of ₹ 4,000 was paid as interest to Mr. R.D. Burman, a non-resident, without deduction of tax at source;
- (iii) ₹ 3,00,000 was paid as salary to a resident individual without deduction of tax at source;
- (iv) Commission of ₹ 15,000 was paid to Mr. Vidyasagar on 2.7.2012. without deduction of tax at source.

Briefly discuss whether any disallowance arises under the provisions of section 40(a)(i)/40(a)(ia) of the Income-tax Act, 1961.

Answer

Disallowance under section 40(a)(i)/40(a)(ia) of the Income-tax Act, 1961 is attracted where the assessee fails to deduct tax at source as is required under the Act, or having deducted tax at source, fails to remit the same to the credit of the Central Government within the stipulated time limit.

The assessee is a resident individual, who was not subjected to tax audit during the immediately preceding previous year i.e., P.Y.2011-12 (as his turnover is less than ₹ 60 lakh in that year) and the TDS obligations have to be considered bearing this in mind.

- (i) The obligation to deduct tax at source from interest paid to a resident arises under section 194A in the case of an individual, only where he was subject to tax audit under section 44AB in the immediately preceding previous year, i.e., P.Y.2011-12. From the data given, it is clear that he was not subject to tax audit under section 44AB in the P.Y.2011-12. Hence, disallowance under section 40(a)(ia) is not attracted in this case.
- (ii) In the case of interest paid to a non-resident, there is obligation to deduct tax at source under section 195, hence non-deduction of tax at source will attract disallowance under section 40(a)(i).
- (iii) Disallowance under section 40(a)(ia) is not attracted for failure to deduct tax at source under section 192 from salaries.
- (iv) The obligation to deduct tax at source under section 194-H from commission paid in excess of ₹ 5,000 to a resident arises in the case of an individual, only where he was subject to tax audit under section 44AB in the immediately preceding previous year. From the data given, it is clear that he was not subject to tax audit under section 44AB in the P.Y.2011-12. Hence, there is no obligation to deduct tax at source under section 194H during the P.Y. 2012-13. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

Question 11

Harish Jayaraj Pvt. Ltd. is converted into Harish Jayaraj LLP on 1.1.2013. The following particulars are available to you:

S.No.	Particulars	₹
(i)	Cost of land	5,00,000
(ii)	WDV of machinery as on 1.4.2012	3,30,000
(iii)	Patents acquired on 1.6.2012	3,00,000
(iv)	Building acquired on 12.3.2011 for which deduction was allowed under section 35AD.	7,00,000
(v)	Above building was revalued as on the date of conversion into LLP as	12,00,000
(vi)	Unabsorbed business loss as on 1.4.2012 (A.Y. 2009-10)	9,00,000

Though the conversion into LLP took place on 1.1.2013, there was disruption of business and the assets were put into use by the LLP only from 1st March, 2013 onwards.

The company earned profits of ₹8 lacs prior to computation of depreciation.

Assuming that the necessary conditions laid down in section 47(xiiib) of the Income-tax Act, 1961 have been complied with, explain the tax treatment of the above in the hands of the LLP.

Answer

Tax treatment of depreciation and unabsorbed business loss of a private company on its conversion into a LLP

The LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company [Section 72A(6A)].

1. Depreciation

The aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them [Section 32(1)]

Therefore, depreciation has to be first calculated as if the conversion had not taken place and then apportioned between the company and the LLP in the ratio of the number of days for which the assets were used by them.

		₹		₹
Block I	Machinery	3,30,000	15%	49,500
Block II	Patents	3,00,000	25%	<u>75,000</u>
				<u>1,24,500</u>

Allocation of depreciation

Depreciation on machinery and patents have to be apportioned between the company and the

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LLP in the ratio of the number of days for which the assets were used by them. Since patents were acquired only on 1.6.2012, it could have been used by the company for 214 days only. Therefore, the depreciation on assets has to be allocated between the company and LLP as follows –

Asset	Total depreciation for the year	Company		LLP	
		No. of days of usage	Depreciation	No. of days of usage	Depreciation
Machinery	49,500	275	44,485	31	5,015
Patents	<u>75,000</u>	214	<u>65,510</u>	31	<u>9,490</u>
	<u>1,24,500</u>		<u>1,09,995</u>		<u>14,505</u>

Therefore, depreciation to be allowed in the hands of the company is ₹ 1,09,995 and depreciation to be allowed in the hands of the LLP is ₹ 14,505.

2. Unabsorbed business loss to be carried forward by the LLP:

Particulars	₹
Profits of the company before depreciation	8,00,000
Less: Current year depreciation	<u>1,09,995</u>
Business income of the company after depreciation	6,90,005
Brought forward business loss	<u>9,00,000</u>
Unabsorbed business loss as on 31.12.2012 to be carried forward by the LLP	<u>2,09,995</u>

3. Actual cost of assets to the LLP

- (1) The actual cost of the block of assets in case of the LLP shall be the WDV of the block of assets as in the case of the company on the date of conversion. The WDV as on 1.1.2013 for Machinery and Patents are ₹ 2,85,515 and ₹ 2,34,490, respectively, which would be the actual cost in the case of the LLP.

WDV of Machinery as on 1.1.2013 = ₹ 3,30,000 – ₹ 44,485 = ₹ 2,85,515

WDV of Patents as on 1.1.2013 = ₹ 3,00,000 – ₹ 65,510 = ₹ 2,34,490

- (2) Land is not a depreciable asset. The cost of acquisition of land to the LLP would be the cost for which the company acquired it, as increased by the cost of improvement.
- (3) In respect of the building, deduction had been allowed in the earlier year under section 35AD. Hence, there is no question of depreciation during the current year. The actual cost of the building to the LLP would be Nil.

Question 12

Mr. Praveen Kumar has furnished the following particulars relating to payments made towards scientific research for the year ended 31.3.2013 :

Sl. No.	Particulars	₹ (in lacs)
(i)	Payments made to K Research Ltd.	20
(ii)	Payment made to LMN College	15
(iii)	Payment made to OPQ College	10
	Note: K Research Ltd. and LMN College are approved research institutions and these payments are to be used for the purposes of scientific research.	
(iv)	Payment made to National Laboratory	8
(v)	Machinery purchased for in-house scientific research	25
(vi)	Salaries to research staff engaged in in-house scientific research	12

Compute the amount of deduction available under section 35 of the Income-tax Act, 1961 while arriving at the business income of the assessee.

Answer

Computation of deduction allowable under section 35

Particulars	Amount (₹ in lacs)	Section	% of weighted deduction	Amount of deduction (₹ in lacs)
Payment for scientific research				
K Research Ltd. [See Note 3]	20	35(1)(ii)	175%	35.00
LMN College	15	35(1)(ii)	175%	26.25
OPQ College [See Note 1]	10	-	Nil	Nil
National Laboratory [See Note 4]	8	35(2AA)	200%	16.00
In-house research [See Note 2]				
Capital expenditure	25	35(1)(iv) r.w. 35(2)	100%	25.00
Revenue expenditure	12	35(1)(i)	100%	<u>12.00</u>
Deduction allowable under section 35				<u>114.25</u>

Notes :-

- 1. Payment to OPQ College :** Since the note in the question below item (iii) clearly mentions that only K Research Ltd. and LMN College (mentioned in item (i) and (ii), respectively) are approved research institutions, it is a logical conclusion that OPQ College mentioned in item (iii) is not an approved research institution. Therefore, payment to OPQ College would not qualify for deduction under section 35.
- 2. Deduction for in-house research and development :** Only company assesseees are entitled to weighted deduction@200% under section 35(2AB) in respect of in-house

research and development expenditure incurred. However, in this case, the assessee is an individual. Therefore, he would be entitled to deduction@100% of the revenue expenditure incurred under section 35(1)(i) and 100% of the capital expenditure incurred under section 35(1)(iv) read with section 35(2), assuming that such expenditure is laid out or expended on scientific research related to his business.

3. **Payment to K Research Ltd. (Alternative Answer)** : Any sum paid to a company registered in India which has as its main object scientific research, as is approved by the prescribed authority, qualifies for a weighted deduction of 125% under section 35(1)(iia). Therefore, it is also possible to take a view that payment of ₹ 20 lakhs to K Research Ltd. qualifies for a weighted deduction of 125% under section 35(1)(iia) since K Research Ltd. is a company. The weighted deduction under section 35(1)(iia) would be ₹ 25 lacs (i.e., 125% of ₹ 20 lacs), in which case, the total deduction under section 35 would be ₹ 104.25 lacs.
4. **Payment to National Laboratory** : The percentage of weighted deduction under section 35(2AA) in respect of amount paid to National Laboratory is 200%.

Question 13

Answer the following with reference to the provisions of the Income-tax Act, 1961 :

- (a) *Bad debt claim disallowed in an earlier assessment year, recovered subsequently. Is the sum recovered, chargeable to tax?*
- (b) *Tax deducted at source on salary paid to employees not remitted till the 'due date' for filing the return prescribed in section 139. Is the expenditure to be disallowed under section 40(a)(ia)?*
- (c) *X Co. Ltd. paid ₹ 120 lakhs as compensation as per approved Voluntary Retirement Scheme (VRS) during the financial year 2012-13. How much is deductible under section 35DDA for the assessment year 2013-14?*

Answer

- (a) Recovery of a bad debt claim disallowed in the earlier year cannot be brought to tax under section 41(4). Section 41(4) can be invoked only in a case where bad debts or part thereof has been allowed as deduction earlier under section 36(1)(vii).
- (b) The salary expenditure is allowable while computing the income of the employer even though TDS has not been deposited within the due date under section 139(1). The disallowance under section 40(a)(ia) will not apply for non-deduction of tax at source from income chargeable under the head "Salaries".
- (c) It is deductible in 5 equal annual instalments commencing from the previous year of payment. ₹ 24 lakhs, being 1/5th of ₹ 120 lakhs, is deductible under section 35DDA for the A.Y.2013-14.

Question 14

What are the conditions to be satisfied for the allowability of expenditure under section 37 of the Income-tax Act, 1961?

Answer

The following conditions are to be fulfilled for the allowability of expenditure under section 37 -

- (1) The expenditure should not be of the nature described in section 30 to 36;
- (2) It should not be in the nature of personal expenditure of the assessee;
- (3) It should have been incurred by the assessee during the previous year;
- (4) The expenditure should have been laid out or expended wholly or exclusively for the purposes of the business or profession;
- (5) It should not be in the nature of a capital expenditure;
- (6) It should not have been incurred for any purpose which is an offence or which is prohibited by law.

Question 15

- (a) *Ramamurthy had 4 heavy goods vehicles as on 1.4.2012. He acquired 7 heavy goods vehicles on 27.6.2012. He sold 2 heavy goods vehicles on 31.5.2012.*

He has brought forward business loss of ₹ 50,000 relating to assessment year 2009-10 of a discontinued business. Assuming that he opts for presumptive taxation of income as per section 44AE, compute his total income chargeable to tax for the assessment year 2013-14.

- (b) *Win Limited commenced the business of operating a three star hotel in Tirupati on 1-4-2012.*

It furnishes you the following information:

- | | | |
|-------|--|-------------|
| (i) | Cost of land (acquired in June 2010) | ₹ 60 lakhs |
| (ii) | Cost of construction of hotel building | |
| | Financial year 2010-11 | ₹ 30 lakhs |
| | Financial year 2011-12 | ₹ 150 lakhs |
| (iii) | Plant and Machineries (all new) acquired during financial year 2011-12 | ₹ 30 lakhs |
| | <i>[All the above expenditures were capitalized in the books of the company]</i> | |
| | Net profit before depreciation for the financial year 2012-13 | ₹ 80 lakhs |

Determine the amount eligible for deduction under section 35AD of the Income-tax Act, 1961, for the assessment year 2013-14.

Answer

(a) Computation of total income of Mr. Ramamurthy for A.Y.2013-14

Particulars	₹
Presumptive business income under section 44AE	
4 heavy goods vehicles for 2 months (4 x ₹ 5,000 x 2)	40,000
Balance 2 heavy goods vehicles for 10 months (2 x ₹ 5,000 x 10)	1,00,000
7 heavy goods vehicles for 10 months (7 x ₹ 5,000 x 10)	<u>3,50,000</u>
Business Income	4,90,000
Less: Brought forward business loss of discontinued business	<u>50,000</u>
Total Income	<u>4,40,000</u>

Note: The assessee is eligible for computing the income from goods carriages applying the presumptive provisions of section 44AE, since he did not own more than 10 goods carriages at any time during the previous year.

- (b) Under section 35AD, 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the specified business, which includes the business of building and operating a hotel of two-star or above category anywhere in India which commences its operations on or after 1.4.2010, would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

Accordingly, the deduction under section 35AD for the A.Y.2013-14 in the case of Win Ltd. would be calculated as follows, assuming that the expenditures were capitalised in the books of the company on 1.4.2012, being the date of commencement of operations-

Particulars	₹ (in lakhs)
Cost of land (not eligible for deduction under section 35AD)	Nil
Cost of construction of hotel building (₹ 30 lakhs + ₹ 150 lakhs)	180
Cost of plant and machinery	<u>30</u>
Deduction under section 35AD	<u>210</u>

Note:-

- (1) For A.Y.2013-14, the loss from specified business of operating a three star hotel would be ₹ 130 lakhs (i.e. ₹ 210 lakhs – ₹ 80 lakhs). As per section 73A, any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year.
- (2) Since the entire cost of plant and machinery and building qualifies for deduction under section 35AD, the same does not qualify for deduction under section 32.

Question 16

Mr. Praveen engaged in retail trade, reports a turnover of ₹ 58,50,000 for the financial year 2012-13. His income from the said business as per books of account is computed at ₹ 2,90,000. Retail trade is the only source of income for Mr. Praveen.

- (i) *Is Mr. Praveen eligible to opt for presumptive determination of his income chargeable to tax for the assessment year 2013-14?*
- (ii) *If so, determine his income from retail trade as per the applicable presumptive provision.*
- (iii) *In case Mr. Praveen does not opt for presumptive taxation of income from retail trade, what are his obligations under the Income-tax Act, 1961?*
- (iv) *What is the due date for filing his return of income under both the options?*

Answer

- (i) Yes. Since his total turnover for the F.Y.2012-13 is below ₹ 100 lakhs, he is eligible to opt for presumptive taxation scheme under section 44AD in respect of his retail trade business.
- (ii) His income from retail trade, applying the presumptive tax provisions under section 44AD, would be ₹ 4,68,000, being 8% of ₹ 58,50,000.
- (iii) In case he does not opt for the presumptive taxation scheme under section 44AD, and claims that his income is ₹ 2,90,000 (which is lower than the presumptive business income of ₹ 4,68,000), he has to maintain books of account as required under section 44AA(2) and also get them audited and furnish a report of such audit under section 44AB, since his total income exceeds the basic exemption limit of ₹ 2,00,000.
- (iv) In case he opts for the presumptive taxation scheme under section 44AD, the due date would be 31st July, 2013.

In case he does not opt for the presumptive taxation scheme and claims that his income is ₹ 2,90,000 as per books of account, then he has to get his books of account audited

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under section 44AB, in which case the due date for filing of return would be 30th September, 2013.

Question 17

Sai Ltd. has a block of assets carrying 15% rate of depreciation, whose written down value on 01.04.2012 was ₹ 40 lacs. It purchased another asset (second-hand plant and machinery) of the same block on 01.11.2012 for ₹ 14.40 lacs and put to use on the same day. Sai Ltd. was amalgamated with Shirdi Ltd. with effect from 01.01.2013.

You are required to compute the depreciation allowable to Sai Ltd. & Shirdi Ltd. for the previous year ended on 31.03.2013 assuming that the assets were transferred to Shirdi Ltd. at ₹ 60 lacs.

Answer

Statement showing computation of depreciation allowable to Sai Ltd. & Shirdi Ltd. for P.Y. 2012-13

Particulars		₹
Written down value (WDV) as on 1.4.2012		40,00,000
Addition during the year (used for less than 180 days)		<u>14,40,000</u>
Total		<u>54,40,000</u>
Depreciation on ₹ 40,00,000 @ 15%		6,00,000
Depreciation on ₹ 14,40,000 @ 7.5%		<u>1,08,000</u>
Total depreciation for the year		<u>7,08,000</u>
Apportionment between two companies:		
(a)	Amalgamating company, Sai Ltd.	
	₹ 6,00,000 × 275/365	4,52,055
	₹ 1,08,000 × 61/151	<u>43,629</u>
		<u>4,95,684</u>
(b)	Amalgamated company, Shirdi Ltd.	
	₹ 6,00,000 × 90/365	1,47,945
	₹ 1,08,000 × 90/151	<u>64,371</u>
		<u>2,12,316</u>

Notes:

- (1) The aggregate deduction, in respect of depreciation allowable to the amalgamating company and amalgamated company in the case of amalgamation shall not exceed in any case, the deduction calculated at the prescribed rates as if the amalgamation had not taken place. Such deduction shall be apportioned between the amalgamating company and the amalgamated company in the ratio of the number of days for which the assets were used by them.

- (2) The price at which the assets were transferred, i.e., ₹ 60 lacs, has no implication in computing eligible depreciation.

Question 18

State the conditions for deductibility of bad debt written off under the Income-tax Act, 1961.

Answer

The conditions for deductibility of bad debts written off under the Income-tax Act, 1961 are -

- (1) There must be a debt – i.e., a bad debt presupposes the existence of a debt and relationship of a debtor and creditor;
- (2) The debt must be incidental to the business or profession of the assessee.
- (3) The debt must have been taken into account in computing the assessable income – No such deduction shall be allowed unless such debt or part thereof was taken into account in computing the income of the assessee of the previous year in which it was written off or of an earlier previous year or it represents money lent in the ordinary course of business of banking or money lending carried on by the assessee.
- (4) The debt must have been written off as irrecoverable in the books of account of the assessee.

Question 19

M/s Arora Ltd., submits the following details of expenditure pertaining to the financial year 2012-13:

- (i) *Payment of professional fees to Mr. Mani ₹ 50,000. Tax was not deducted at source.*
- (ii) *Interior works done by Mr. Hari for ₹ 2,00,000 on a contract basis. Payment made in the month of March 2013. Tax deducted in March 2013 was paid on 30.06.2013.*
- (iii) *Factory Rent paid to Mr. Rao ₹ 15,00,000. Tax deducted at source and paid on 01.10.2013.*
- (iv) *Interest paid on Fixed Deposits ₹ 2,00,000. Tax deducted on 31.12.2012 and paid on 28.09.2013.*

Examine the above with reference to allowability of the same in the assessment year 2013-14 under the Income-tax Act, 1961. Your answer must be with reference to section 40(a) read with relevant tax deduction at source provisions.

Answer

Allowability of expenses of M/s. Arora Ltd. for the A.Y. 2013-14

- (i) Payment of professional fees is subject to TDS under section 194J. Since no tax is deducted at source, the expenditure of ₹ 50,000 is disallowed under section 40(a)(ia).
- (ii) Since the tax was deducted in March, 2013 and paid on or before the due date of

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filing the return (i.e., on or before September 30th, 2013), the expenditure on interior works will be allowed as deduction. Hence, disallowance under section 40(a)(ia) is not attracted.

- (iii) The maximum time allowable for deposit of tax deducted at source is upto the due date of filing of return i.e., 30th September, 2013. In this case, since tax deducted under section 194-I was paid after the due date of filing the return, the expenditure can be claimed only in the subsequent year i.e., P.Y. 2013-14. Hence, for the P.Y. 2012-13, the expenditure of ₹ 15,00,000 is disallowed under section 40(a)(ia).
- (iv) The tax deducted at source could be deposited on or before the due date of filing of return to avoid disallowance under section 40(a)(ia). In this case, disallowance would not be attracted since tax deducted during December 2012 was deposited before 30th September 2013 i.e. on 28.09.2013.

Question 20

Mr. Raju, a manufacturer at Chennai, gives the following Manufacturing, Trading and Profit & Loss Account for the year ended 31.03.2013.

Manufacturing, Trading and Profit & Loss Account for the year ended 31.03.2013

Particulars	₹	Particulars	₹
To Opening Stock	71,000	By Sales	32,00,000
To Purchase of Raw Materials	16,99,000	By Closing stock	2,00,000
To Manufacturing Wages & Expenses	5,70,000		
To Gross Profit	<u>10,60,000</u>		
	<u>34,00,000</u>		<u>34,00,000</u>
To Administrative charges	3,26,000	By Gross Profit	10,60,000
To State VAT penalty	5,000	By Dividend from domestic companies	15,000
To State VAT paid	1,10,000	By Income from agriculture (net)	1,80,000
To General Expenses	54,000		
To Interest to Bank (On machinery term loan)	60,000		
To Depreciation	2,00,000		
To Net Profit	<u>5,00,000</u>		
	<u>12,55,000</u>		<u>12,55,000</u>

Following are the further information relating to the financial year 2012-13:

- (i) Administrative charges include ₹ 46,000 paid as commission to brother of the assessee. The commission amount at the market rate is ₹ 36,000.

- (ii) The assessee paid ₹ 33,000 in cash to a transport carrier on 29.12.2012. This amount is included in manufacturing expenses (Assume that the provisions relating to TDS are not applicable to this payment.)
- (iii) A sum of ₹ 4,000 per month was paid as salary to a staff throughout the year and this has not been recorded in the books of account.
- (iv) Bank term loan interest actually paid upto 31.03.2013 was ₹ 20,000 and the balance was paid in October 2013.
- (v) Housing loan principal repaid during the year was ₹ 50,000 and it relates to residential property occupied by him. Interest on housing loan was ₹ 23,000. Housing loan was taken from Canara Bank. These amounts were not dealt with in the profit and loss account given above.
- (vi) Depreciation allowable under the Act is to be computed on the basis of following information:

Plant & Machinery (Depreciation rate @ 15%)	₹
Opening WDV (as on 01.04.2012)	12,00,000
Additions during the year (used for more than 180 days)	2,00,000
Total additions during the year	4,00,000
Note: Ignore additional depreciation under section 32(1)(ia)	

Compute the total income of Mr. Raju for the assessment year 2013-14.

Note: Ignore application of section 14A for disallowance of expenditures in respect of any exempt income.

Answer

Computation of total income of Mr. Raju for the A.Y. 2013-14

Particulars	₹	₹
Profits and gains of business or profession		
Net profit as per profit and loss account		5,00,000
Add: Excess commission paid to brother disallowed under section 40A(2)	10,000	
Disallowance under section 40A(3) is not attracted since the limit for one time cash payment is ₹ 35,000 in respect of payment to transport operators. Therefore, amount of ₹ 33,000 paid in cash to a transport carrier is allowable as deduction.	Nil	
Salary paid to staff not recorded in the books (Assuming that the expenditure is in the nature of unexplained expenditure and hence, is deemed to be income as per	48,000	

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section 69C and would be taxable @ 30% under section 115BBE – no deduction allowable in respect of such expenditure) [See Note 1 below]		
Bank term loan interest paid after the due date of filing of return under section 139(1) – disallowed as per section 43B	40,000	
State VAT penalty paid disallowed [See Note 2 below]	5,000	
Depreciation debited to profit and loss account	<u>2,00,000</u>	<u>3,03,000</u>
		8,03,000
Less: Dividend from domestic companies [Exempt under section 10(34)]	15,000	
Income from agriculture [Exempt under section 10(1)]	1,80,000	
Depreciation under the Income-tax Act, 1961 (As per working note)	<u>2,25,000</u>	<u>4,20,000</u>
		3,83,000
Income from house property		
Annual value of self-occupied property	Nil	
Less: Deduction under section 24(b) – interest on housing loan	<u>23,000</u>	<u>(23,000)</u>
Gross Total Income		3,60,000
Less: Deduction under section 80C in respect of Principal repayment of housing loan		<u>50,000</u>
Total Income		<u>3,10,000</u>

Working Note:

Computation of depreciation under the Income-tax Act, 1961

Particulars	₹
Depreciation@15% on ₹ 14 lakh (Opening WDV of ₹ 12 lakh plus assets purchased during the year and used for more than 180 days ₹ 2 lakh)	2,10,000
Depreciation @7.5% on ₹ 2 lakh (Cost of assets used for less than 180 days)	<u>15,000</u>
	<u>2,25,000</u>

Notes (Alternate views):

1. It is also possible to take a view that the salary not recorded in the books of account was an erroneous omission and that the assessee has offered satisfactory explanation for the same. In such a case, the same should not be added back as unexplained expenditure, but would be allowable as deduction while computing profits and gains of business and profession.
2. Where the imposition of penalty is not for delay in payment of sales tax or VAT but for contravention of provisions of the Sales Tax Act (or VAT Act), the levy is not compensatory and therefore, not deductible. However, if the levy is compensatory in

nature, it would be fully allowable. Where it is a composite levy, the portion which is compensatory is allowable and that portion which is penal is to be disallowed.

Since the question only mentions "State VAT penalty paid" and the reason for levy of penalty is not given, it has been assumed that the levy is not compensatory and therefore, not deductible. It is also possible to assume that such levy is compensatory in nature and hence, allowable as deduction. In such a case, the total income would be ₹ 3,05,000.

Question 21

Mr. Tenzingh is engaged in composite business of growing and curing (further processing) coffee in Coorg, Karnataka. The whole of coffee grown in his plantation is cured. Relevant information pertaining to the year ended 31.3.2013 are given below:

Particulars	₹
WDV of car as on 1.4.2012	3,00,000
WDV of machinery as on 1.4.2012 (15% rate)	15,00,000
Expenses incurred for growing coffee	3,10,000
Expenditure for curing coffee	3,00,000
Sale value of cured coffee	22,00,000

Besides being used for agricultural operations, the car is also used for personal use; disallowance for personal use may be taken at 20%. The expenses incurred for car running and maintenance are ₹ 50,000. The machines were used in coffee curing business operations.

Compute the income arising from the above activities for the assessment year 2013-14. Show the WDV of the assets as on 31.3.2013.

Answer

Where an assessee is engaged in the composite business of growing and curing of coffee, the income will be segregated between agricultural income and business income, as per Rule 7B of the Income-tax Rules, 1962.

As per the above Rule, income derived from sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and 25% of such income shall be deemed to be income liable to tax. The balance 75% will be treated as agricultural income.

Particulars	₹	₹	₹
Sale value of cured coffee			22,00,000
Less: Expenses for growing coffee		3,10,000	
Car expenses (80% of ₹ 50,000)		40,000	
Depreciation on car (80% of 15% of ₹ 3,00,000)		<u>36,000</u>	

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Total costs of agricultural operations		3,86,000	
Expenditure for coffee curing operations	3,00,000		
Add: Depreciation on machinery (15% of 15,00,000) (See Note below)	<u>2,25,000</u>		
Total cost of the curing operations		<u>5,25,000</u>	
Total cost of composite operations			<u>9,11,000</u>
Total profits from composite activities			<u>12,89,000</u>
Amount regarded as business income (25% of above)			3,22,250
Amount treated as agricultural income (75% of above)			9,66,750

Computation of value of depreciable assets as on 31.3.2013

Particulars	₹	₹	₹
Car Opening value as on 1.4.2012		3,00,000	
Depreciation thereon at 15%	45,000		
Less: Disallowance @20% for personal use	<u>9,000</u>		
Depreciation actually allowed		<u>36,000</u>	
Closing value as on 31.3.2013			2,64,000
Machinery Opening value as on 1.4.2012		15,00,000	
Less: Depreciation @ 15%		<u>2,25,000</u>	
Closing value as on 31.3.2013			12,75,000

Explanation 7 to section 43(6) provides that in cases of 'composite income', for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee (and not just 25%) is chargeable under the head "Profits and gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

Question 22

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 31-3-2013:

S. No.	Particulars	₹
(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 2013-14.

Answer

Computation of business income and agricultural income of Ms.Vivitha for the A.Y.2013-14

Sr. No.	Source of income	Gross (₹)	Business income		Agricultural income
			%	₹	₹
(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	-
(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		Nil	
				-	80,000
	Total			5,40,000	5,90,000

Notes:

- 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.
- 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 23

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

	₹
Financial year 2010-11	1,15,000
Financial year 2011-12	1,80,000
Financial year 2012-13	2,10,000

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 ₹ 1,50,000; or
- (ii) if it is a new profession which is setup in the relevant previous year, it is likely to exceed ₹ 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 ₹ 1,50,000 in financial year 2010-11, the requirement under section 44AA to compulsorily maintain the prescribed books of account is not applicable to him.

Question 24

M/s Sidhant & Co., a sole proprietary concern is converted into a company, Sidhant Co. Ltd. with effect from November 29, 2012. The written down value of assets as on April 1, 2012 is as follows:

Items	Rate of Depreciation	WDV as on 1st April, 2012
Building	10%	₹ 3,50,000
Furniture	10%	₹ 50,000
Plant and Machinery	15%	₹ 2,00,000

Further, on October 15, 2012, M/s Sidhant & Co. purchased a plant for ₹ 1,00,000 (rate of depreciation 15%). After conversion, the company added another plant worth ₹ 50,000 (rate of depreciation 15%).

Compute the depreciation available to (i) M/s Sidhant & Co. and (ii) Sidhant Co. Ltd. for Asst. year 2013-14.

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.

Computation of depreciation allowable to Sidhant & Co. for A.Y.2013-14

Particulars	₹	₹
Building		
WDV as on 1.4.2012	3,50,000	
Depreciation@10%		35,000
Furniture		
WDV as on 1.4.2012	50,000	
Depreciation@10%		5,000
Plant and Machinery		
WDV as on 1.4.2012	2,00,000	
Add: Additions during the year (purchased on 15.10.2012)	<u>1,00,000</u>	
	3,00,000	
Less: Depreciation for the year		
(15% of ₹ 2,00,000 + 50% of 15% of ₹ 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. 1.4.2012 to 28.11.2012)	46,411	
(i.e. $242/365 \times ₹ 70,000$)		
On new machine for 45 days i.e., $45/168 \times ₹ 7,500$	<u>2,009</u>	48,420

Computation of depreciation allowable to Sidhant Co. Ltd. for A.Y.2013-14

Particulars	₹	₹
(i) Depreciation on the assets on conversion		
Proportionately for 123 days i.e. after conversion period		

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(123/365 × ₹ 70,000) + (123/168 × 7,500) = 23,589 + 5,491	29,080
(ii) Depreciation @ 50% of normal rate of 15% on ₹ 50,000, being the value of plant purchased after conversion, which was put to use for less than 180 days	<u>3,750</u>
Depreciation allowable to Sidhant Co. Ltd.	<u>32,830</u>

Note: Since it has not been specifically mentioned that M/s Sidhant & Co. and Sidhant Co. Ltd. are manufacturing concerns or companies engaged in the business of generation or generation and distribution of power, additional depreciation is not provided for.

Question 25

Following is the profit and loss account of Mr. A for the year ended 31.3.2013:

Particulars	₹	Particulars	₹
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	<u>94,500</u>		
	<u>6,15,500</u>		<u>6,15,500</u>

Following additional information is furnished:

- (1) Repairs on building includes ₹ 95,000 being cost of raising a compound wall for the own business premises.
- (2) Interest payments include interest of ₹ 12,000 payable outside India to a resident Indian on which tax has not been deducted and penalty of ₹ 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 31.3.2013 ignoring depreciation.

Answer

Profits and gains of business or profession of Mr. A for the year ended 31.3.2013

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

Interest payable outside India to a resident, as tax has not been deducted at source [Section 40(a)]	12,000	
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	
Contribution for scientific research (to be treated separately)	<u>1,00,000</u>	<u>2,31,000</u>
		3,25,500
Less: Income not forming part of business income		
Interest from company deposits	6,400	
Dividend	3,600	
Income Tax refund	<u>4,500</u>	
		<u>14,500</u>
		3,11,000
Less: Deduction under section 35 for scientific research [See Note below]		<u>1,75,000</u>
Profit and gains of business or profession		<u>1,36,000</u>

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

Question 26

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 27

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.

Question 28

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 29

Mr. Sukhvinder is engaged in the business of plying goods carriages. On 1st April, 2012, he owns 10 trucks (out of which 6 are heavy goods vehicles). On 2nd May, 2012, he sold one of the heavy goods vehicles and purchased a light goods vehicle on 6th May, 2012. This new vehicle could however be put to use only on 15th June, 2012.

Compute the total income of Mr. Sukhvinder for the assessment year 2013-14, taking note of the following data :

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

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 ₹ 5,000 from a heavy goods vehicle and ₹ 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 ₹ 5,75,500 (See Notes 1 & 2 below) and his total income would be ₹ 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 ₹ 45,000 instead of ₹ 5,75,500 and his total income would be ₹ 1,15,000.

Notes :

1. Computation of total income of Mr. Sukhvinder for A.Y. 2013-14

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

2. Calculation of presumptive income as per section 44AE

Type of carriage	No. of months	Rate per month	Amount
(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	<u>49,500</u>
		Total	<u>5,75,500</u>

Question 30

A car purchased by S on 10.8.2008 for ₹ 3,25,000 for personal use is brought into the business of the assessee on 01.12.2012, when its market value is ₹ 1,50,000.

Compute the actual cost of the car and the amount of depreciation for the Assessment year 2013-14 assuming the rate of depreciation to be 15%.

Answer

In this case, the car was purchased for personal use on 10.8.2008 for ₹ 3,25,000 and subsequently brought into the business of the assessee on 1.12.2012. The “actual cost” of car is ₹ 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.2013-14 is ₹ 48,750 (i.e.15% of ₹ 3,25,000). As the car was not acquired during the previous year 2012-13, 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 31

Gopichand Industries furnishes you the following information :

	(₹)
Block I WDV of Plant and machinery (consisting of 10 looms)	5,00,000
Rate of depreciation 15%	
Block II WDV of Buildings (consisting of 3 buildings)	12,50,000
Rate of depreciation 10%	
Acquired on 5-07-2012 – 5 looms for	4,00,000
Sold on 7-12-2012 – 15 looms for	10,00,000
Acquired on 10-01-2013 – 2 looms for	3,00,000
Compute depreciation claim for the Assessment year 2013-14.	

Answer

Computation of depreciation for Gopichand Industries for A.Y.2013-14

Particulars	₹	₹
Block 1 : Plant & machinery (Rate of depreciation – 15%)		
WDV as on 1 st April (10 looms)	5,00,000	
Add : Additions during the year 5 looms acquired on 5 th July	4,00,000	
2 looms acquired on 10 th January	<u>3,00,000</u>	
	12,00,000	
Less : Assets sold during the year 15 looms sold on 7 th December	<u>10,00,000</u>	
W.D.V. as on 31 st March (2 looms)	2,00,000	
Depreciation on ₹ 2 lakhs @ 15% (limited to 50%)		15,000
Block II:Buildings (Rate of depreciation – 10%)		
WDV as on 1 st April (3 buildings)	12,50,000	
Depreciation on ₹ 12,50,000 @ 10%		<u>1,25,000</u>
Total depreciation for the year		<u>1,40,000</u>

Notes:

- 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. No additional depreciation @ 20% of the cost of new plant and machinery is provided for assuming that all conditions contained in the section 32(1)(ia) have not been fulfilled.

Question 32

M/s. QQ & Co., a sole proprietary concern, was converted into a company on 1.9.2012. Before the conversion, the sole proprietary concern had a Block of Plant and Machinery (Rate of depreciation 15%), whose WDV as on 1.4.2012 was ₹ 3,00,000. On 1st April itself, a new plant of the same block was purchased for ₹ 1,20,000. After the conversion, the company has purchased the same type of Plant on 1.1.2013 for ₹ 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.

	(₹)
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 ₹ 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

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

The depreciation of ₹ 12,000 [50% of 15% on ₹ 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 or a company engaged in the generation or generation and distribution of power, additional depreciation has not been provided for.

Question 33

Mr. Sivam, a retail trader of Cochin gives the following Trading and Profit and Loss Account for the year ended 31st March, 2013:

Trading and Profit and Loss Account for the year ended 31.03.2013

Particulars	₹	Particulars	₹
To Opening stock	90,000	By Sales	12,11,500
To Purchases	10,04,000	By Income from UTI	2,400
To Gross Profit	<u>3,06,000</u>	By Closing stock	<u>1,86,100</u>
	<u>14,00,000</u>		<u>14,00,000</u>
To Salary	60,000	By Gross profit b/d	3,06,000
To Rent and rates	36,000		
To Interest on loan	15,000		
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	<u>50,000</u>		
	<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	₹ 9,000
---------------	---------

Closing stock	₹ 18,000
---------------	----------

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

- (iii) The whole amount of printing and stationery was paid in cash by way of one time payment.

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

The written down value of plant and machinery is ₹ 4,20,000 as on 01.04.2012. A new plant falling under the same block of depreciation was bought on 1.7.2012 for ₹ 70,000. Two old plants were sold on 1.10.2012 for ₹ 50,000.

- (v) Rent and rates includes sales tax liability of ₹3,400 paid on 7.4.2013.

(vi) Other general expenses include ₹ 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. 2013-14

Particulars	₹	₹
Net Profit as per profit and loss account		50,000
Add: 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	<u>2,000</u>	<u>1,58,300</u>
		2,08,300
Less: Deductions items:		
Under valuation of opening stock	9,000	
Income from UTI [Exempt under section 10(35)]	<u>2,400</u>	<u>11,400</u>
Business income before depreciation		1,96,900
Less: Depreciation (See Note 1)		<u>66,000</u>
		<u>1,30,900</u>

Computation of business income as per section 44AD -

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

The business income under section 44AD is ₹ 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.

Notes:

1. Calculation of depreciation

Particulars	₹
WDV of the block of plant & machinery as on 1.4.2012	4,20,000

Add :Cost of new plant & machinery	70,000
	4,90,000
Less : Sale proceeds of assets sold	50,000
WDV of the block of plant & machinery as on 31.3.2013	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.	

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 34

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, 2012 for ₹ 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 where the resident payee has not paid the tax due on such 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 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 ₹ 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).

- (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)(viii) 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.

Question 35

Swadeshi Ltd., which follows mercantile system of accounting, obtained licence on 1.6.2011 from the Department of telecommunication for a period of 10 years. The total licence fee payable is ₹18,00,000. The relevant details are:

Year ended 31 st March	Licence fee payable for the year (₹)	Payments made	
		Date	Amount (₹)
2012	10,00,000	30.03.2012	3,70,000
		15.05.2012	6,30,000
2013	8,00,000	28.02.2013	5,40,000

Balance of ₹2,60,000 is pending as on 31.3.2013.

Compute the amount of deduction available to the assessee under section 35ABB for the assessment years 2012-13 and 2013-14. 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. ₹ 3,70,000 paid on 30.03.2012 [P.Y.2011-12]

Unexpired period of licence 10 years

Hence ₹ 37,000 [i.e. ₹ 3,70,000/10] can be claimed under section 35ABB for period of 10 years commencing from A.Y.2012-13.

2. ₹ 11,70,000 paid during year ended 31.03.2013 [P.Y.2012-13]

Unexpired period of licence 9 years

Hence, ₹ 1,30,000 [i.e. ₹ 11,70,000/9] can be claimed under section 35ABB for a period of 9 years commencing from A.Y.2013-14.

3. Amount of deduction u/s 35ABB

Assessment year	Amount (₹)
2012-13	37,000
2013-14	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 36**

X Ltd. follows mercantile system of accounting. After negotiations with the bank, interest of ₹ 4 lakhs (including interest of ₹ 1.2 lakhs pertaining to year ended 31.03.2013) has been converted into loan. Can the interest of ₹ 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.

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 ₹ 1.2 lakhs converted into loan cannot be claimed as business expenditure.

Question 37

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:

Year ended	Item	Amount (₹)
31.03.2010	Land	10,00,000
(Incurred after 1.9.2009)	Building	25,00,000
31.03.2011	Plant and machinery	5,00,000
31.03.2012	Raw materials	2,20,000
31.03.2013	Raw materials and salaries	1,80,000

The business was commenced on 01-09-2012.

In view of availability of better model of plant and machinery, the existing plant and machinery

were sold for ₹ 8,00,000 on 1.03.2013.

Discuss the implications of the above for the assessment year 2013-14 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

- As per section 35(2AB), 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 Finance Act, 2012 has extended the benefit of weighted deduction under this section for expenditure incurred upto 31st March 2017 on in-house research and development facility. Prior to this amendment, the deduction was restricted to such expenditure incurred on or before 31.03.2012.

The eligible expenditure and quantum of deduction will be:

- Current year capital expenditure except expenditure in the nature of cost of any land or building or revenue expenditure incurred for scientific research (weighted deduction @ 200%).
- 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	₹
(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 ₹ 1,80,000 [200% of ₹ 1,80,000 is allowable under section 35(2AB)]		3,60,000
Total deduction under section 35		35,80,000

- 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. ₹ 8,00,000

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

₹ 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 38

Mr. B.A. Patel, a non-resident, operates an aircraft between London to Ahmedabad. For the Financial year ended on 31st March, 2013, he received the amounts as under:

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

The total expenditure incurred by Mr. B.A. Patel for the purposes of the business for the financial year 2012-13 was ₹ 1.4 crores.

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 2013 relevant to assessment year 2013-14.

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:

4.94 Income-tax

Particulars	₹
(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 ₹ 7,50,000, being 5% of ₹ 1,50,00,000.

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

Question 39

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 40

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 41

Briefly explain the term "substantial interest". State three 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.

Question 42

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 31.3.2013, 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 2013-2014:

Sl. No.	Particulars	₹
(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.2013-14

	Particulars	Business Income (₹)	Agricultural Income (₹)
(a)	Income from manufacture of rubber (Rule 7A) Business income is 35% of ₹ 5,00,000 Agricultural income is 65% of ₹ 5,00,000	1,75,000	3,25,000
(b)	Income from growing and curing of coffee (Rule 7B) Business income is 25% of ₹ 3,50,000 Agricultural income is 75% of ₹ 3,50,000	87,500	2,62,500
(c)	Income from manufacture of tea (Rule 8) Business income is 40% of ₹ 7,00,000 Agricultural income is 60% of ₹ 7,00,000	2,80,000	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 43

Fill in the blanks:

- Where a company has incurred a capital expenditure of ₹ 1,00,000 towards promoting family planning amongst employees, ₹ will be allowed as deduction in the current year and the balance in succeeding years.
- A motor car is the only asset in a block. Cost ₹ 2,00,000. Rate of depreciation is 15%. 20% is disallowed for estimated personal use. WDV of the block is ₹
- 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.
- A private limited company incurred a capital expenditure of ₹ 5,00,000 on 1.4.2011 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) ₹ 1,76,000.
- (iii) Nil / 0 %.
- (iv) subject to depreciation under section 32
- (v) date of transfer of the asset.

Question 44

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 ₹ 25,000 has been allowed on accrual basis and in a later year, in respect of the said expenditure, assessee makes the payment of ₹ 25,000 through a cheque crossed "& Co.", disallowance of ₹ 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, 1961.
- (iv) The mediclaim premium paid to GIC by Mr. Lomesh for his employees, by a draft, on 27.12.2012 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 ₹ 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 or in the business of generation or generation and distribution of power. 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 45

Write short notes on:

- (i) *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.*
- (ii) *Carry forward and set off of unabsorbed depreciation.*
- (iii) *Additional depreciation.*

Answer

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

(ii) 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.

(iii) Section 32(1)(iia) 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 or in the business of generation or generation and distribution of power, 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 or generation or generation and

distribution of power. 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.

EXERCISES

1. *An assessee uses plant and machinery for the purpose of carrying on his business. Under section 31, he shall be eligible for deduction on account of -*
 - a) *both capital and revenue expenditure on repairs*
 - b) *current repairs*
 - c) *current repairs plus 1/5th of capital expenditure on repairs.*
2. *An electricity company charging depreciation on straight line method on each asset separately, sells one of its machinery in April, 2012 at ₹ 1,20,000. The WDV of the machinery at the beginning of the year i.e. on 1st April, 2012 is ₹ 1,35,000. No new machinery was purchased during the year. The shortfall of ₹ 15,000 is treated as -*
 - a) *Terminal depreciation*
 - b) *Short-term capital loss*
 - c) *Normal depreciation.*
3. *X Ltd. acquires an asset which was previously used for scientific research for ₹ 2,75,000. The asset was brought into use for the business of X Ltd., after the research was completed. The actual cost of the asset to be included in the block of assets is -*
 - a) *Nil*
 - b) *Market value of the asset on the date of transfer to business*
 - c) *₹ 2,75,000 less notional depreciation under section 32 upto the date of transfer.*
4. *A Ltd. has unabsorbed depreciation of ₹ 4,50,000 for the P.Y.2012-13. This can be carried forward -*
 - a) *for a maximum period of 8 years and set-off against business income.*
 - b) *Indefinitely and set-off against business income.*
 - c) *Indefinitely and set-off against any head of income.*

5. *Deduction under section 33AB is allowed to an assessee provided the assessee deposits the profits with NABARD -*
 - a) *before the end of the previous year*
 - b) *within 6 months from the end of the previous year*
 - c) *within 6 months from the end of the previous year or before the due date for filing the return of income, whichever is earlier.*
6. *XYZ Ltd. incurred capital expenditure of ₹ 1,50,000 on 1.4.2012 for acquisition of patents and copyrights. Such expenditure is -*
 - a) *Eligible for deduction in 14 years from A.Y.2013-14*
 - b) *Eligible for deduction in 5 years from A.Y.2013-14*
 - c) *Subject to depreciation under section 32*
7. *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 relevant for A.Y.2013-14 and the maximum number specified under the section are -*
 - a) *₹ 5,000 for a heavy goods carriage and ₹ 4,500 for other goods carriages for an assessee owning not more than 10 goods carriages at any time during the year*
 - b) *₹ 3,500 per carriage for an assessee owning not more than 10 goods carriages at the end of the previous year*
 - c) *₹ 5,000 for a heavy goods carriage and ₹ 4,500 for other goods carriages for an assessee owning not more than 12 goods carriages at the end of the previous year*
8. *In the case of a non-resident engaged in the business of operation of aircraft, the income is determined under section 44BBA at -*
 - a) *7.5% of turnover*
 - b) *10% of turnover*
 - c) *5% of turnover*
9. *The W.D.V. of a block (Plant and Machinery, rate of depreciation 15%) as on 1.4.2012 is ₹ 3,20,000. A machinery costing ₹ 50,000 was acquired on 1.9.2012 but put to use on 1.11.2012. During Jan'2013, part of this block was sold for ₹ 2,00,000. The depreciation for A.Y.2013-14 would be -*
 - a) *₹ 21,750*
 - b) *₹ 25,500*
 - c) *₹ 21,125*
10. *Employer's contribution to provident fund/superannuation fund/gratuity fund is allowed as deduction in computing income under the head "Profits and gains of business or profession", provided it has been paid -*
 - a) *before the end of the previous year*
 - b) *on or before the due date by which the employer is required to credit an employee's contribution to the employee's account in the relevant fund.*

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- c) on or before the due date for filing the return of income under section 139(1).
11. Is it compulsory for an assessee to claim depreciation under section 32 of the Income-tax Act, 1961?
12. Write short notes on -
- (i) Enhanced depreciation
 - (ii) Set-off and carry forward of unabsorbed depreciation.
13. Discuss the provisions dealing with the computation of business income on a presumptive basis in case of resident assessee.
14. Discuss the concept of "block of assets" under the Income-tax Act, 1961.
15. Which are the deductions allowable only on actual payment under section 43B?
16. Write short notes on the following -
- (a) Compulsory maintenance of books of accounts
 - (b) Compulsory tax audit.
 - (c) Shipping business in case of non-resident.
 - (d) The circumstances where the provisions of section 40A(3), regarding cash payments in excess of ₹ 20,000, does not apply.
 - (e) Amortisation of expenditure under voluntary retirement scheme.
 - (f) Deduction to be allowed on actual payment basis.
 - (g) Special provisions under section 44DA for computing income by way of royalty, fee for technical services, etc. in case of non-residents.
17. What is the tax treatment regarding cash payments in excess of limits prescribed in section 40A(3)?
18. The written down value of plant and machinery in the books of Alpha Ltd. is ₹ 75,00,000 as on 1st April, 2012, on which date, the installed capacity of the company was 12,000 tons. Alpha Ltd. borrowed ₹ 10,00,000@10%p.a. from ICICI Bank on 1.8.2012 for purchase of new plant and machinery for extension of its existing business, which would increase its installed capacity to 13,000 tons. The new plant and machinery was purchased on the same date but was put to use only w.e.f. 1.11.2012. Compute the depreciation admissible under section 32 for the A.Y.2013-14, assuming the applicable rate of depreciation on plant and machinery to be 15%.
19. (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.
20. Discuss the provisions of tax audit under section 44AB of the Income-tax Act, 1961.
21. 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.

Answers

1. b; 2. a; 3. a; 4. c; 5. c; 6. c; 7. a; 8. c; 9. a; 10. C 18. ₹ 13,04,375.

UNIT 4 : Capital Gains

Question 1

Dinesh received a vacant site as gift from his friend in November 2002. The site was acquired by his friend for ₹ 3,00,000 in April 1990. Dinesh constructed a residential building during the year 2004-05 in the said site for ₹ 15,00,000. He carried out some further extension of the construction in the year 2007-08 for ₹ 5,00,000.

Dinesh sold the residential building for ₹ 55,00,000 in January 2013 but the State stamp valuation authority adopted ₹ 65,00,000 as value for the purpose of stamp duty.

Compute his long term capital gain, for the assessment year 2013-14 based on the above information. The cost inflation index are as follows:

Financial Year	Cost inflation index
1990-91	182
2002-03	447
2004-05	480
2007-08	551
2012-13	852

Answer

Computation of long term capital gain of Dinesh for the A.Y. 2013-14

Particulars	₹	₹
Full value of consideration (Note 1)		65,00,000
Less: Indexed cost of acquisition-land (₹ 3,00,000 × 852/447) (Note 2 & 3)	5,71,812	
Indexed Cost of acquisition-building (₹ 15,00,000 × 852/ 480) (Note 3)	26,62,500	
Indexed Cost of improvement-building (₹ 5,00,000 × 852/551)	7,73,140	40,07,452
Long-term capital gain		<u>24,92,548</u>

Notes:

- 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 value adopted by the Stamp Valuation Authority, such value adopted by the Stamp Valuation Authority shall be deemed to be the full value of the consideration received or accruing as a result of such transfer. Accordingly, full value of consideration will be ₹ 65 lakhs in this case.

2. Since Dinesh has acquired the asset by way of gift, therefore, as per section 49(1), cost of the asset to Dinesh shall be deemed to be cost for which the previous owner acquired the asset i.e., ₹ 3,00,000, in this case.
3. Indexation benefit is available since both land and building are long-term capital assets. However, as per the definition of indexation cost of acquisition under clause (iii) of *Explanation* below section 48, indexation benefit for land will be available only from the previous year in which Mr. Dinesh first held the asset i.e., P.Y. 2002-03.

Alternative view: In the case of *CIT v. Manjula J. Shah* 16 Taxmann 42 (Bom.), the Bombay High court held that indexation cost of acquisition in case of gifted asset can be computed with reference to the year in which the previous owner first held the asset.

As per this view, the indexation cost of acquisition of land would be ₹ 14,04,396 and long term capital gain would be ₹ 16,59,964.

Question 2

Mr. Abhishek, a senior citizen, pledged his residential house with a bank under a notified reverse mortgage scheme. He was getting loan from bank in monthly installments. Mr. Abhishek did not repay the loan on maturity and hence gave possession of the house to the bank to discharge his loan. How will the treatment of long-term capital gain be 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 pledging of residential house with bank by Mr. Abhishek 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. Therefore, the monthly instalment amounts received by Mr. Abhishek would not be taxable.

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.

Note: In the question, it has been given that the borrower who is a senior citizen did not repay the loan on maturity and hence gave possession of the house to the bank to discharge the loan. It may be noted that, generally, under a Reverse Mortgage Scheme of a bank, alienation of house property for recovery of loan with accumulated interest takes place only after the death of the borrower and not during his life time unless there has been a violation of any of the terms and conditions subject to which the loan was granted. In this case, it is presumed

that there has been such a violation, due to which the repayment of loan has fallen due during the life time of the senior citizen.

Question 3

Anshu transfers land and building on 02-01-2013 and furnishes the following information:

Particulars	(₹)
(i) Net consideration received	18,00,000
(ii) Value adopted by Stamp Valuation Authority	20,00,000
(iii) Value ascertained by Valuation Officer on reference by the Assessing Officer	21,00,000
(iv) This land was acquired by Anshu on 1-04-1981. Fair Market value of the land as on 01-04-1081 was	1,10,000
(v) A Residential building was constructed on land by Anshu at a cost of ₹3,20,000 (construction completed on 01-12-2002 during financial year 2002-03) Brought forward short term capital loss incurred on sale of shares during financial year 2008-09 ₹1,50,000,	

Anshu seeks your advice regarding the amount to be invested in NHAI bonds so as to be exempt from capital gain tax under the Income-tax Act, 1961.

Cost inflation index for FY 1981-1982 : 100

Cost inflation index for FY 2002-2003 : 447

Cost inflation index for FY 2012-2013 : 852

Answer

Computation of Capital Gains of Ms. Anshu for the A.Y. 2013-14

Particulars	₹	₹
Full value of consideration [See Notes (i) & (ii) below]		20,00,000
Less: Indexed Cost of acquisition [See Note (iii) below]		
Indexed cost of land (₹ 1,10,000 × 852/100)	9,37,200	
Indexed cost of building (₹ 3,20,000 × 852/447)	<u>6,09,933</u>	<u>15,47,133</u>
Long-term capital gain		4,52,867
Less: Brought forward short-term capital loss set off [See Note (iv) below]		<u>1,50,000</u>
Taxable capital gains (Amount to be invested in NHAI bonds to get full exemption from tax on capital gains) [See Note (v) below]		3,02,867

Notes :

- (i) As per section 50C(1), 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 by the Stamp Valuation Authority for the purpose of payment of stamp duty, such value adopted by the Stamp Valuation Authority shall be deemed to be the full value of the consideration received or accruing as a result of such transfer. Accordingly, full value of consideration would be ₹ 20 lakhs in this case.
- (ii) As per section 50C(3), where the valuation is referred by the Assessing Officer to Valuation Officer and the value ascertained by such Valuation Officer exceeds the value adopted by the Stamp Valuation Authority for the purpose of payment of stamp duty, the value adopted 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. ₹ 21 lakhs) is higher than the value adopted by the Stamp Valuation Authority (i.e. ₹ 20 lakhs), the full value of consideration in this case would be ₹ 20 lakhs.
- (iii) Since the cost of land acquired by Anshu on 1.4.1981 is not given in the question, the fair market value as on 1.4.1981 is taken as the cost of acquisition. Indexation benefit is available since land and building are both long-term capital assets, as they are held by Anshu for more than 36 months.
- (iv) As per section 74, 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. Therefore, short-term capital loss on sale of shares during the F.Y.2008-09 can be set-off against the current year long-term capital gains on sale of land and building.
- (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 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 gains or the amount of such investment made, whichever is less. Therefore, in this case if Anshu invests the entire capital gains of ₹ 3,02,867 (rounded off to ₹ 3,03,000) in bonds of NHAI, she can get full exemption from tax on capital gains.

Question 4

Mr. Mithun purchased 100 shares of M/s Goodmoney Co. Ltd. on 01-04-2005 at rate of ₹1,000 per share, in public issue of the company.

Company allotted bonus shares in the ratio of 1:1 on 01.12.2011. He has also received dividend of ₹10 per share on 01.05.2012.

He has sold all the shares on 01.10.2012 at the rate of ₹ 3,000 per share through a recognized stock exchange and paid brokerage of 1% and securities transaction tax of 0.02% to celebrate his 75th birthday. The cost inflation Index are as follows:

Financial Year	Cost Inflation Index
2005-06	497
2012-13	852

Compute his total income and tax liability for Assessment Year 2013-14 assuming that he is having no income other than given above.

Answer

Computation of total income and tax liability of Mr. Mithun from A.Y. 2013-14

Particulars	₹
Short term capital gains on sale of bonus shares	
Gross sale consideration (100 x ₹ 3,000)	3,00,000
Less : Brokerage @ 1%	<u>3,000</u>
Net sale consideration	2,97,000
Less: Cost of acquisition of bonus shares	<u>NIL</u>
Total Income (Short term Capital Gains)	<u>2,97,000</u>
Tax Liability	
15% of (₹ 2,97,000-₹ 2,50,000)	7,050
Add : Education cess @ 2%	141
Secondary and higher education cess @ 1%	<u>71</u>
Tax payable	<u>7,262</u>
Tax payable (Rounded Off)	7,260

Notes:

- (1) Long-term capital gains on sale of original shares through a recognized stock exchange (STT paid) is exempt under section 10(38).
- (2) Since bonus shares are held for less than 12 months before sale, the gain arising there from is a short term capital gain chargeable to tax@15% as per section 111A after adjusting the unexhausted basic exemption limit. Since Mr. Mithun is over 60 years of age, he is entitled for a higher basic exemption limit of ₹ 2,50,000 for A.Y. 2013-14.
- (3) Dividend income is exempt under section 10(34).
- (4) Brokerage paid is allowable since it is an expenditure incurred wholly and exclusively in connection with the transfer. Hence, it qualifies for deduction under section 48(i).
- (5) However, as per fifth proviso to section 48, securities transaction tax is not allowable as deduction.

Question 5

Mr. Selvan, acquired a residential house in January, 2000 for ₹ 10,00,000 and made some improvements by way of additional construction to the house, incurring expenditure of ₹ 2,00,000 in October, 2004. He sold the house property in October, 2012 for ₹ 75,00,000. The value of property was adopted as ₹ 80,00,000 by the State stamp valuation authority for registration purpose. He acquired a residential house in January, 2012 for ₹ 25,00,000. He deposited ₹ 20,00,000 in capital gains bonds issued by National Highways Authority of India (NHAI) in June, 2013.

Compute the capital gain chargeable to tax for the assessment year 2013-14.

What would be the tax consequence and in which assessment year it would be taxable, if the house property acquired in January, 2012 is sold for ₹ 40,00,000 in March, 2014?

Cost inflation index : F.Y. 1999-2000 = 389

F.Y. 2004-2005 = 480

F.Y. 2012-2013 = 852

Answer**(I) Computation of Capital Gains Chargeable to tax for A.Y. 2013-14**

Particulars	₹	₹
Sale consideration (i.e. Stamp Duty Value) (Note-1)		80,00,000
Less: Indexed Cost of Acquisition		
₹ 10,00,000 × 852/389	21,90,231	
Indexed Cost of Improvement		
₹ 2,00,000 × 852/480	<u>3,55,000</u>	<u>25,45,231</u>
		54,54,769
Less: Capital Gains exemption under section 54 (Note-2)		<u>25,00,000</u>
Taxable Capital Gains		<u>29,54,769</u>

Notes -

- As per the provisions of section 50C, in case the stamp duty value adopted by the stamp valuation authority is higher than the actual sale consideration, the stamp duty value shall be deemed as the full value of consideration.
- Exemption under section 54 is available if a new residential house is purchased within one year before or two years after the date of transfer. Since the cost of new residential house is less than the capital gain, capital gain to the extent of cost of new asset is exempt under section 54.
- Exemption under section 54EC is available in respect of investment in bonds of National Highways Authority of India only if the investment is made within a period of six months after the date of such transfer. In this case, since the investment is made after six months, exemption under section 54EC would not be available.

- (II) If the new asset purchased by the assessee on the basis of which exemption under section 54 is claimed, is transferred within 3 years from the date of its acquisition, then for computing the taxable short-term capital gain on such transfer, the capital gain exempted earlier shall be reduced from the cost of acquisition of such asset.

Hence, in the present case, if the house property acquired in January, 2012 is sold for ₹ 40,00,000 in March, 2014 (i.e. before the expiry of 3 years from the date of acquisition), the capital gains exempted earlier (i.e. ₹ 25,00,000) would be reduced from the cost of acquisition (i.e. ₹ 25,00,000) to arrive at the short-term capital gains for A.Y. 2014-15.

Particulars	₹	₹
Sale consideration		40,00,000
Less: Cost of acquisition	25,00,000	
Capital gains exempted earlier	<u>(25,00,000)</u>	<u>Nil</u>
Short-term Capital Gains		<u>40,00,000</u>

Question 6

Mr. Rakesh purchased a house property on 14th April, 1979 for ₹1,05,000. He entered into an agreement with Mr. B for the sale of house on 15th September, 1982 and received an advance of ₹ 25,000. However, since Mr. B did not remit the balance amount, Mr. Rakesh forfeited the advance.

Later on, he gifted the house property to his friend Mr. A on 15th June, 1986.

Following renovations were carried out by Mr. Rakesh and Mr. A to the house property:

	₹
By Mr. Rakesh during FY 1979-80	10,000
By Mr. Rakesh during FY 1983-84	50,000
By Mr. A during FY 1993-94	1,90,000

The fair market value of the property as on 1.4.1981 is ₹ 1,50,000.

Mr. A entered into an agreement with Mr. C for sale of the house on 1st June, 1995 and received an advance of ₹ 80,000. The said amount was forfeited by Mr. A, since Mr. C could not fulfil the terms of the agreement.

Finally, the house was sold by Mr. A to Mr. Sanjay on 2nd January, 2013 for a consideration of ₹ 12,00,000.

Compute the capital gains chargeable to tax in the hands of Mr. A for the assessment year 2013-14. Cost inflation indices are as under:

Financial Year	Cost inflation index
1981-82	100

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1983-84	116
1986-87	140
1993-94	244
2012-13	852

Answer

Computation of capital gains chargeable to tax in the hands of Mr. A

Particulars	₹
Sale consideration	12,00,000
Less: Indexed cost of acquisition (Note 1)	<u>4,26,000</u>
	7,74,000
Less: Indexed cost of improvement (Note 2)	<u>10,30,684</u>
Long term capital loss	<u>(2,56,684)</u>

Note 1

Indexed cost of acquisition is determined as under:

Cost to the previous owner i.e. Mr. Rakesh is ₹ 1,05,000

Fair Market Value on 1st April, 1981 is ₹ 1,50,000

Cost to the previous owner or FMV on 1st April, 1981, whichever is more, is to be taken as cost of acquisition of Mr. A

₹ 1,50,000

Less: Advance money forfeited by Mr. A (as per section 51)

(Note : Advance forfeited by Mr. Rakesh, the previous owner, should, however, not be deducted)

₹ 80,000

Cost of acquisition

₹ 70,000

Indexed cost of acquisition (₹ 70,000 × 852/140)

₹ 4,26,000

140 is the Cost Inflation Index for F.Y. 1986-87, being the first year in which property is held by Mr. A and 852 is the Cost Inflation Index for F.Y. 2012-13, being the year in which the property is sold.

Alternative view: In the case of *CIT v. Manjula J. Shah* 16 Taxmann 42 (Bom.), the Bombay High Court held that the indexed cost of acquisition in case of gifted asset can be computed with reference to the year in which the previous owner first held the asset.

As per this view, the indexation cost of acquisition of house would be ₹ 5,96,400 taking Cost Inflation Index of 100 for the F.Y. 1980-81 since F.M.V. as on 1st April, 1981 is taken as cost of acquisition of Mr. A.

Note 2

Indexed cost of Improvement is determined as under:

Expenditure incurred before 1st April, 1981 should not be considered NIL

Expenditure incurred on or after 1st April, 1981

- During 1983-84	Indexed cost of Improvement	[₹ 50,000 × 852/116]	₹ 3,67,241
- During 1993-94	Indexed cost of Improvement	[₹ 1,90,000 × 852/244]	₹ 6,63,443

Total indexed cost of improvement **₹10,30,684**

Question 7

X Co. (P) Ltd., converted into a Limited Liability Partnership (LLP) by name All Trade LLP, with effect from 01.04.2012.

The following details are given to you:

Asst. year 2005-06 : Business loss brought forward ₹ 2,00,000

Asst. year 2012-13 : Business loss brought forward ₹ 5,00,000

(These are related to erstwhile X Co. (P) Ltd.)

Total income of All Trade LLP, for the financial year 2012-13 (Before ₹ 6,00,000

set off of brought forward business losses of erstwhile company i.e.

X Co. (P) Ltd.)

Assume that all the conditions prescribed in section 47(xiiib) were satisfied by X Co. (P) Ltd. at the time of conversion in to LLP.

- (i) Explain whether All Trade LLP can set off and carry forward the business loss of its predecessor i.e. X Co. (P) Ltd.?*
- (ii) State whether any change in partners of All Trade LLP at later date would have any tax consequence.*

Answer

- (i)** Section 72A(6A), provides that where a private company is succeeded by a LLP fulfilling the conditions laid down in the proviso to section 47(xiiib), then, notwithstanding anything contained in any other provision of the Income-tax Act, 1961, the accumulated loss and unabsorbed depreciation of the predecessor company shall be deemed to be the loss or allowance for depreciation of the successor LLP for the purpose of the previous year in which the business reorganisation was effected and other provisions of the Act relating to set-off and carry forward of losses and depreciation allowance shall apply accordingly.

Therefore, All Trade LLP can carry forward and set-off the business loss of ₹ 7 lakh of erstwhile X Co (P) Ltd. against its business income for the F.Y.2012-13. The unabsorbed business loss of ₹ 1 Lac, relating to A.Y. 2012-13, will be carried forward to the next year.

- (ii) Section 47(xiiib) requires that the shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company. Further, the erstwhile shareholders of the company should continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion. If the entity fails to fulfil this condition, the benefit of set-off of business loss availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfil the condition.

Question 8

Ms. Chhaya transferred a vacant site to Ms. Dayama for ₹ 4,25,000. The stamp valuation authority fixed the value of vacant site for stamp duty purpose at 6,00,000. The total income of Chhaya and Dayama before considering the transfer of vacant site are ₹ 50,000 and ₹ 2,05,000, respectively. The indexed cost of acquisition for Ms. Chhaya in respect of vacant site is ₹ 4,00,000 (computed).

Determine the total income of both Ms. Chhaya and Ms. Dayama taking into account the above said transaction.

Answer

Transfer of immovable property for inadequate consideration will not have any tax implication in the hands of transferee under section 56(2)(vii). Therefore, in the hands of transferee, i.e., Ms. Dayama, the provisions of section 56(2)(vii) would not be attracted. However, for the transferor, Ms. Chhaya, the value adopted for stamp duty purpose will be taken as the deemed sale consideration under section 50C for computation of capital gains.

Particulars	Chhaya (Transferor) ₹	Dayama (Transferee) ₹
Capital gains		
Deemed sale consideration under section 50C	6,00,000	
Less: Indexed cost of acquisition	<u>4,00,000</u>	
	2,00,000	
Other income (computed)	<u>50,000</u>	<u>2,05,000</u>
Total income	<u>2,50,000</u>	<u>2,05,000</u>

Question 9

Mr. Chandru transferred a vacant site on 28.10.2012 for ₹ 100 lakhs. The site was acquired for ₹ 9,99,300 on 30.6.2000. He invested ₹ 50 lakhs in eligible bonds issued by Rural Electrification Corporation Ltd. (RECL) on 20.3.2013.

Again, he invested ₹ 20 lakhs in eligible bonds issued by National Highways Authority of India (NHAI) on 16.4.2013.

Compute the chargeable capital gain in the hands of Chandru for the A.Y. 2013-14.

<i>Financial year</i>	<i>Cost Inflation Index</i>
2000-01	406
2012-13	852

Answer

Computation of chargeable capital gain of Mr. Chandru for the A.Y.2013-14

Particulars	₹	₹
Sale consideration		1,00,00,000
Less: Indexed cost of acquisition ($\text{₹ } 9,99,300 \times 852/406$)		<u>20,97,053</u>
		79,02,947
Less: Deduction under section 54EC		
20.03.2013 RECL bonds	50,00,000	
16.04.2013 NHAI bonds	<u>20,00,000</u>	<u>70,00,000</u>
Long term capital gain		<u>9,02,947</u>

Note:

- (1) Since the site was held for more than 36 months prior to the date of transfer, it is a long-term capital asset and the capital gain arising upon its transfer is long-term capital gain.
- (2) In order to claim exemption under section 54EC, Mr. Chandru has to invest in specified bonds of RECL or NHAI within a period of 6 months from the date of transfer of the asset.
- (3) However, investments made in such bonds by an assessee during any financial year cannot exceed ₹ 50 lakhs.

In this case, Mr. Chandru has invested ₹ 50 lakhs in RECL bonds in the F.Y.2012-13 and ₹ 20 lakhs in NHAI bonds in the F.Y.2013-14, both within six months from the date of transfer. He has, therefore, fulfilled both the conditions and hence, he is eligible to claim exemption of ₹ 70 lakhs under section 54EC.

Question 10

How will you calculate the period of holding in case of the following assets?

- (1) *Shares held in a company in liquidation*
- (2) *Bonus shares*
- (3) *Flat in a co-operative society*
- (4) *Transfer of a security by a depository (i.e., demat account)*

Answer

- (1) **Shares held in a company in liquidation** - The period after the date on which the company goes into liquidation shall be excluded while calculating the period of holding. Therefore, the period of holding shall commence from the date of acquisition and end

with the date on which the company goes into liquidation.

- (2) **Bonus shares** - The period of holding shall be reckoned from the date of allotment of bonus shares and will end with the date of transfer.
- (3) **Flat in a co-operative society** - The period of holding shall be reckoned from the date of allotment of shares in the society and will end with the date of transfer.

Note – Any transaction whether by way of becoming a member of, or acquiring shares in, a co-operative society or by way of any agreement or any arrangement or in any other manner whatsoever which has the effect of transferring, or enabling enjoyment of, any immovable property is a transfer as per section 2(47)(vi). Hence, it is possible to take a view that any date from which such right is obtained may be taken as the date of acquisition.

- (4) **Transfer of security by a depository** - The period of holding shall be computed from the date on which the securities were credited to the demat account and will end with the date of transfer (sale). The first-in-first-out (FIFO) method will be adopted for determining the period of holding.

Question 11

Mr. A is a proprietor of Akash Enterprises having 2 units. He transferred on 1.4.2012 his Unit 1 by way of slump sale for a total consideration of ₹ 25 lacs. Unit 1 was started in the year 2001-02. The expenses incurred for this transfer were ₹ 28,000. His Balance Sheet as on 31.3.2012 is as under:

Liabilities	Total (₹)	Assets	Unit 1 (₹)	Unit 2 (₹)	Total (₹)
Own Capital	15,00,000	Building	12,00,000	2,00,000	14,00,000
Revaluation Reserve (for building of unit 1)	3,00,000	Machinery	3,00,000	1,00,000	4,00,000
Bank loan (70% for unit 1)	2,00,000	Debtors	1,00,000	40,000	1,40,000
Trade creditors (25% for unit 1)	<u>1,50,000</u>	Other assets	<u>1,50,000</u>	<u>60,000</u>	<u>2,10,000</u>
Total	<u>21,50,000</u>	Total	<u>17,50,000</u>	<u>4,00,000</u>	<u>21,50,000</u>

Other information:

- (i) Revaluation reserve is created by revising upward the value of the building of Unit 1.
- (ii) No individual value of any asset is considered in the transfer deed.
- (iii) Other assets of Unit 1 include patents acquired on 1.7.2010 for ₹ 50,000 on which no depreciation has been charged.

Compute the capital gain for the assessment year 2013-14.

Answer**Computation of capital gains on slump sale of Unit 1**

Particulars	₹
Sale value	25,00,000
Less: Expenses on sale	<u>28,000</u>
Net sale consideration	24,72,000
Less: Net worth (See Note 1 below)	<u>12,50,625</u>
Long term capital gain	<u>12,21,375</u>

Notes:**1. Computation of net worth of Unit 1 of Akash Enterprises**

Particulars	₹	₹
Building (excluding ₹ 3 lakhs on account of revaluation)		9,00,000
Machinery		3,00,000
Debtors		1,00,000
Patents (See Note 2 below)		28,125
Other assets (₹ 1,50,000 – ₹ 50,000)		<u>1,00,000</u>
Total assets		14,28,125
Less: Creditors	37,500	
Bank Loan	<u>1,40,000</u>	<u>1,77,500</u>
Net worth		<u>12,50,625</u>

2. Written down value of patents as on 1.4.2012

Value of patents:	₹
Cost as on 1.7.2010	50,000
Less: Depreciation @ 25% for Financial Year 2010-11	<u>12,500</u>
WDV as on 1.4.2011	37,500
Less: Depreciation for Financial Year 2011-12	<u>9,375</u>
WDV as on 1.4.2012	<u>28,125</u>

For the purposes of computation of net worth, the written down value determined as per section 43(6) has to be considered in the case of depreciable assets. The problem has been solved assuming that the Balance Sheet values of ₹ 3 lakh and ₹ 9 lakh (₹ 12 lakh – ₹ 3 lakh) represent the written down value of machinery and building, respectively, of Unit 1.

3. Since the Unit is held for more than 36 months, capital gain arising would be long term capital gain. However, indexation benefit is not available in case of slump sale.

Question 12

Sachin received ₹ 15,00,000 on 23.01.2013 on transfer of his residential building in a transaction of reverse mortgage under a scheme notified by the Central Government. The building was acquired in March 1991 for ₹ 8,00,000.

Is the amount received on reverse mortgage chargeable to tax in the hands of Sachin under the head 'Capital gains'?

Cost inflation index for the Financial year 1990-91 - 182

Financial year 2012-13 - 852

Answer

As per section 47(xvi), any transfer of a capital asset in a transaction of Reverse Mortgage under a scheme made and notified by the Central Government will not be regarded as a transfer. Therefore, capital gains tax liability is not attracted.

Section 10(43) provides that the amount received by a senior citizen as a loan, either in lump sum or in installments, in a transaction of Reverse Mortgage would be exempt from income-tax. Therefore, the amount received by Sachin in a transaction of Reverse Mortgage of his residential building is exempt under section 10(43).

Question 13

Mukesh (aged 55 years) owned a residential house at Nagpur. It was acquired by Mukesh on 10.10.1986 for ₹ 4,00,000. It was sold for ₹ 55,00,000 on 4.11.2012. The State stamp valuation authority fixed the value of the property at ₹ 60,00,000. The assessee paid 2% of the sale consideration as brokerage for the sale of said property.

Mukesh acquired a residential house at Chennai on 10.12.2012 for ₹ 15,00,000 and deposited ₹ 10,00,000 on 10.4.2013 in the capital gain bond of Rural Electrification Corporation Ltd. (RECL). He deposited ₹ 5,00,000 on 6.07.2013 in the Capital Gain Deposit Scheme in a nationalized bank for construction of additional floor on the residential house property acquired at Chennai.

Compute the capital gain chargeable to tax in the hands of Mr. Mukesh for the assessment year 2013-14. Calculate the income-tax payable on the assumption that he has no other income chargeable to tax.

Cost inflation index : Financial year 1986-87 = 140

Financial year 2012-13 = 852

Answer**Computation of capital gains in the hands of Mukesh for the A.Y. 2013-14**

Particulars	₹	₹
Deemed sale consideration (under section 50C)		60,00,000

Less: Brokerage @ 2% of ₹ 55,00,000		<u>1,10,000</u>
Net sale consideration		58,90,000
Less: Indexed cost of acquisition (₹ 4,00,000 × 852/140)		<u>24,34,286</u>
		34,55,714
Less: Exemption under sections 54 and 54EC		
Exemption under section 54 in respect of –		
(i) residential house acquired at Chennai on 10.12.2012	15,00,000	
(ii) amount deposited in Capital Gains Accounts Scheme on 06.07.2013 (before the due date of filing of return) for construction of additional floor on the residential house property acquired at Chennai		
	<u>5,00,000</u>	
	20,00,000	
Deduction under section 54EC in respect of amount deposited in RECL bonds on 10.04.2013 (within six months from the date of transfer)	<u>10,00,000</u>	<u>30,00,000</u>
Taxable long-term capital gain		<u>4,55,714</u>

Computation of tax liability of Mr. Mukesh for A.Y.2013-14

Particulars	₹
Tax on ₹ 2,55,714 (i.e., long term capital gain ₹ 4,55,714 less basic exemption limit of ₹ 2,00,000) @20%	51,143
Add: Education cess @ 2%	1,023
Secondary and higher education cess@1%	<u>511</u>
Total tax liability	<u>52,677</u>

Question 14

Mr. Raj Kumar sold a house to his friend Mr. Dhuruv on 1st November, 2012 for a consideration of ₹ 25,00,000. The Sub-Registrar refused to register the document for the said value, as according to him, stamp duty had to be paid on ₹ 45,00,000, which was the Government guideline value. Mr. Raj Kumar preferred an appeal to the Revenue Divisional Officer, who fixed the value of the house as ₹ 32,00,000 (₹ 22,00,000 for land and the balance for building portion). The differential stamp duty was paid, accepting the said value determined. Assuming that the fair market value is ₹ 32,00,000, what are the tax implications in the hands of Mr. Raj Kumar and Mr. Dhuruv for the assessment year 2013-14? Mr. Raj Kumar had purchased the land on 1st June, 2009 for ₹ 5,19,000 and completed the construction of house on 1st October, 2010 for ₹ 14,00,000.

Cost inflation indices may be taken as 632 for the financial year 2009-10, 711 for the financial year 2010-11 and 852 for the financial year 2012-13.

Answer**In the hands of the seller, Mr. Raj Kumar**

As per section 50C(1), where the consideration received or accruing as a result of transfer of land or building or both, is less than the value adopted or assessed or assessable by the stamp valuation authority, the value adopted or assessed or assessable by the stamp valuation authority shall be deemed to be the full value of consideration received or accruing as a result of transfer.

Where the assessee appeals against the stamp valuation and the value is reduced in appeal by the appellate authority (Revenue Divisional Officer, in this case), such value will be regarded as the consideration received or accruing as a result of transfer.

In the given problem, land has been held for a period exceeding 36 months and building for a period less than 36 months immediately preceding the date of transfer. So land is a long-term capital asset, while building is a short-term capital asset.

Particulars	₹
Long term capital gain on sale of land	
Consideration received or accruing as a result of transfer of land	22,00,000
Less: Indexed cost of acquisition ₹ 5,19,000 x 852/632	<u>6,99,665</u>
Long-term capital gain (A)	<u>15,00,335</u>
Short-term capital loss on sale of building	
Consideration received or accruing from transfer of building	10,00,000
Less: Cost of acquisition	<u>14,00,000</u>
Short term capital loss (B)	<u>4,00,000</u>

As per section 70, short-term capital loss can be set-off against long-term capital gains. Therefore, the net taxable long-term capital gains would be ₹ 11,00,335 (i.e., ₹ 15,00,335 – ₹ 4,00,000).

In the hands of the buyer Mr. Dhuruv

As per section 56(2)(vii), where an individual receives from a non-relative, any immovable property without consideration, and the stamp value (or the value reduced by the appellate authority, as in this case) exceeds ₹ 50,000, then the stamp duty value of such property is chargeable to tax as income from other sources. Therefore, only transfer of immovable property without consideration would fall within the scope of section 56(2)(vii). Accordingly, the provisions of section 56(2)(vii) would not be attracted in case if transfer of immovable property for inadequate consideration.

Question 15

Compute the net taxable capital gains of Smt. Megha on the basis of the following information-

A house was purchased on 1.5.1997 for ₹ 4,50,000 and was used as a residence by the owner. The owner had contracted to sell this property in June, 2007 for ₹ 10 lacs and had

received an advance of ₹ 70,000 towards sale. The intending purchaser did not proceed with the transaction and the advance was forfeited by the owner. The property was sold in April, 2012 for ₹ 15,00,000. The owner, from out of sale proceeds, invested ₹ 4 lacs in a new residential house in January, 2013.

Cost inflation index :- 1997-98 - 331

2012-13 - 852

Answer

Computation of net taxable capital gains of Smt. Megha for the A.Y.2013-14

Particulars	₹
Full value of consideration	15,00,000
Less: Expenses on transfer	<u>Nil</u>
Net sale consideration	15,00,000
Less: Indexed cost of acquisition (See Working note below)	<u>9,78,127</u>
Long term capital gain (since the period of holding is more than 3 years)	5,21,873
Less: Exemption under section 54 (See Note 1 below)	<u>4,00,000</u>
Taxable long term capital gain	<u>1,21,873</u>

Working Note:

Indexed cost of acquisition

	₹
Purchase price	4,50,000
Less: Amount forfeited (See Note 2 below)	<u>70,000</u>
Cost of acquisition	<u>3,80,000</u>

Indexed cost of acquisition	$\frac{3,80,000 \times 852}{331}$	9,78,127
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Notes:

- (1) Exemption under section 54 is available if a new residential house is purchased within two years from the date of transfer of existing residential house, which is a long-term capital asset. Since the cost of new residential house is less than the long-term capital gains, capital gains to the extent of cost of new house, i.e., ₹ 4 lakh, is exempt under section 54.
- (2) As per section 51, any advance received and retained by the assessee, as a result of earlier negotiations for sale of the asset, shall be deducted from the purchase price for computing the cost of acquisition of the asset.

Question 16

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.
- (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. However, the dividend referred in to in section 115-O is exempt under section 10(34).
- (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 17

Singhania & Co. own six machines, put in use for business in March, 2012. The depreciation on these machines is charged @ 15%. The written down value of these machines as on 1st April, 2012 was ₹ 8,50,000. A new plant was bought for ₹ 8,50,000 on 30th November, 2012.

Three of the old machines were sold on 10th June, 2012 for ₹ 11,00,000.

You are required to:

- determine the claim of depreciation for Assessment Year 2013-14.*
- compute the capital gains liable to tax for Assessment Year 2013-14.*
- If Singhania & Co. had sold the three machines in June, 2012 for ₹ 21,00,000, will there be any difference in your above workings? Explain.*

Answer

(i) Computation of depreciation for A.Y.2013-14

Particulars	₹
W.D.V. of the block as on 1.4.2012	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 31.03.2013	<u>6,00,000</u>

Since the value of the block as on 31.3.2013 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 ₹ 45,000, being 7½% of ₹ 6,00,000.

Note- It is assumed that the firm is not eligible for additional depreciation.

- The provisions under section 50 for computation of capital gains in the case of depreciable assets can be invoked only under the following circumstances:
 - When one or some of the assets in the block are sold for consideration more than the value of the block.
 - When all the assets are transferred for a consideration more than the value of the block.
 - When all the assets are transferred for a consideration less than the value of the block.

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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, 2012 for ₹ 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.

Particulars	₹	₹
Sale consideration		21,00,000
Less:		
W.D.V. of the machines as on 1.4.2012	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 18

Paulomi has transferred 1,000 shares of Hetal Ltd., (which she acquired at a cost of ₹ 10,000 in the financial year 2002-03) to Dhaval, her brother, at a consideration of ₹ 3,12,934 on 15.5.2012 privately.

During the financial year 2012-13, she has paid through e-banking ₹ 15,000 towards medical premium, ₹ 50,000 towards L.I.P. and ₹ 25,000 towards PPF.

Assuming she has no other source of income, compute her total income and tax payable for the Assessment Year 2013-14.

Cost Inflation Index:

F.Y.2002- 03 - 447

F.Y.2012- 13 - 852

Answer

Computation of total income and tax liability of Paulomi for Assessment year 2013-14

Particulars	₹
Sale consideration	3,12,934
Less: Indexed cost of acquisition ₹ 10,000 × 852/447	<u>19,060</u>
Long term capital gain	<u>2,93,874</u>
Total income	2,93,870
Tax liability	
Income-tax @ 20% on ₹ 93,870 (₹ 2,93,870 – ₹ 2,00,000)	18,774

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 ₹ 2,00,000 to the extent of long-term capital gain can be reduced from the long-term capital gain.

Question 19

Aarav converts his plot of land purchased in July, 2002 for ₹ 80,000 into stock-in-trade on 31st March, 2012. The fair market value as on 31.3.2012 was ₹ 1,90,000. The stock-in-trade was sold for ₹ 2,25,000 in the month of January, 2013.

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. 2002 – 2003</i>	<i>- 447</i>
<i>F.Y. 2011 – 2012</i>	<i>- 785</i>
<i>F.Y. 2012 – 2013</i>	<i>- 852</i>

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. 2013-14.

Particulars	₹
Capital Gains	
Full value of consideration (Fair market value on the date of conversion)	1,90,000
Less: Expenses on transfer	<u>Nil</u>
Net sale consideration	1,90,000
Less: Indexed cost of acquisition ($\text{₹ } 80,000 \times 785/447$)	<u>1,40,492</u>
Long-term capital gain	<u>49,508</u>
Profits & Gains of Business or Profession	
Sale price of stock-in-trade	2,25,000
Less: Fair market value on the date of conversion	<u>1,90,000</u>
	<u>35,000</u>

Computation of taxable income of Mr. Aarav for A.Y.2013-14

Particulars	₹
Profits and gains from business or profession	35,000
Long term capital gains	<u>49,508</u>
	<u>84,508</u>

Question 20

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. Indexation benefit is available upto the year of conversion of capital asset in stock-in-trade.

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 21

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 a stage carriage permit from Mr. B for ₹ 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 22

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:

Particulars	₹
Building completed in September, 2007 for	10,00,000
Land appurtenant thereto purchased in April, 2001 for	12,00,000
Advance received from a prospective buyer for land in May, 2002, forfeited in favour of assessee, as negotiations failed	50,000
WDV of the building block as on 1.4.2012	8,74,800
Sale value of factory building in November, 2012	8,00,000
Sale value of appurtenant land in November, 2012	25,00,000

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 2013-14 and the amount to be invested under section 54EC for availing the maximum exemption.

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Cost inflation indices are as under :

Financial Year	Cost inflation index
2001-02	426
2002-03	447
2012-13	852

Answer

Computation of taxable capital gain of Mr. Malik for A.Y.2013-14

Particulars	₹	₹
Factory building		
Sale price of building	8,00,000	
Less: WDV as on 1.4.2012	<u>8,74,800</u>	
Short-term capital loss on sale of building		(-) 74,800
Land appurtenant to the above building		
Sale value of land	25,00,000	
Less: Indexed cost of acquisition ($\text{₹ } 11,50,000 \times 852/426$)	<u>23,00,000</u>	
Long-term capital gains on sale of land		<u>2,00,000</u>
Chargeable long term capital gain		<u>1,25,200</u>

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 ₹ 1,25,200 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.
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 ₹ 74,800 can be set-off against long-term capital gain of ₹ 2,00,000.

Question 23

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 ₹ 6,50,000. Certain portion of the machinery could be salvaged. The opening WDV of the block as on 1-4-2012 was ₹ 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, 2003 for ₹ 1,20,000. The market value of these two items as on the date of fire accident was ₹ 1,80,000.

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

(i) Towards loss of stock	₹ 4,80,000
(ii) Towards damage of machinery	₹ 6,00,000
(iii) Towards gold chain and diamond ring	₹ 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, ₹ 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, ₹ 4,80,000 being the excess of written down value (i.e ₹ 10,80,000) over the insurance compensation (i.e. ₹ 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 ₹ 1,80,000.

Question 24

Mr. A who transfers land and building on 2.01.2013, furnishes the following information:

- (i) Net consideration received ₹ 12 lakhs.
- (ii) Value adopted by stamp valuation authority, which was not contested by Mr. A ₹ 18 lakhs.
- (iii) Value ascertained by Valuation Officer on reference by the Assessing Officer ₹ 20 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 ₹ 1,10,000.
- (v) A residential building was constructed on the above land by Mr. A at a cost of ₹ 3,20,000 (construction completed on 1.12.2003) during the financial year 2003-04.
- (vi) Brought forward unabsorbed short-term capital loss (incurred on sale of shares during the financial year 2009-10) ₹ 2,05,000.

Mr. A seeks your advice as to the amount to be invested in NHAI/RECL bonds so as to be exempt from clutches of capital gain tax. Cost inflation indices for the financial years 1981-82, 2003-04 & 2012-13 are 100, 463 and 852 respectively.

Answer

Computation of Capital Gains of Mr. A for the Assessment Year 2013-14

Particulars	₹	₹
Full value of consideration (deemed) (See Note-1&2) (Indexation benefit is available since land and buildings are long-term capital assets)		18,00,000
Less: Indexed cost of land ($₹ 1,10,000 \times 852/100$)	9,37,200	
Indexed cost of building ($₹ 3,20,000 \times 852/463$)	<u>5,88,855</u>	<u>15,26,055</u>
Long-term capital gain		2,73,945
Less: Brought forward short-term capital loss set off (See Note-4)		<u>2,05,000</u>
Amount to be invested in NHAI / RECL bonds		<u>68,945</u>

Notes :

- (1) 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, the full value of consideration will be ₹ 18 lakhs in this case.
- (2) 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. ₹ 20 lakhs) is higher than the value adopted by the stamp valuation authority (i.e. ₹ 18 lakhs), the full value of consideration in this case is ₹ 18 lakhs.
- (3) 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.
- (4) 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.
- (5) 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 25

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 4.4.2012, this land is compulsorily acquired by the Central Government of India on a compensation fixed and paid by it for ₹ 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 26

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 or HUF transfers his agricultural land which has been used by the individual or his parents or HUF 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.
- (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. 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 special economic zone. 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.

Question 27

Mr. Y submits the following information pertaining to the year ended 31st March, 2013:

- (i) On 30.11.2012, when he attained the age of 60, his friends in India gave a flat at Surat as a gift, each contributing a sum of ₹ 20,000 in cash. The cost of the flat purchased using the various gifts was ₹ 3.40 lacs.
- (ii) His close friend abroad sent him a cash gift of ₹ 75,000 through his relative for the above occasion.
- (iii) Mr. Y sold the above flat on 30.1.2013 for ₹ 3.6 lacs. The Registrar's valuation for stamp duty purposes was ₹ 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 5.2.2007 for ₹ 3.5 lacs. These shares were sold on 15.3.2013 for ₹ 2.8 lacs.

You are requested to calculate the total income of Mr. Y for the assessment year 2013-14.

[Cost Inflation Index for F.Y. 2006-07 – 519, F.Y. 2011-12 – 785, 2012-13: 852]

Answer

Computation of total income of Mr.Y for A.Y. 2013-14

Particulars	₹	₹	₹
Capital Gains			
Short term capital gains (on sale of flat)			
(i) Sale consideration	3,60,000		
(ii) Stamp duty valuation	<u>3,70,000</u>		
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)(vii) will be the cost of acquisition]		<u>3,40,000</u>	30,000
Long term capital loss on sale of equity shares of X Pvt. Ltd			
Sale consideration		2,80,000	

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Less: Indexed cost of acquisition(₹ 3,50,000 × 852/519)	5,74,566	
Long term capital loss to be carried forward (See Note 1 below)	2,94,566	
Income from other sources:		
Gift from friends by way of immovable property on 30.11.2012 [See Note 3 below].		3,40,000
Gift received from a close friend (unrelated person) [See Note 2 below]		<u>75,000</u>
Total income		<u>4,45,000</u>

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 ₹ 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 28

Bala sold his vacant site on 21.09.2012 for ₹ 7,00,000. It was acquired by him on 01.10.1995 for ₹ 1,50,000.

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

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

Cost inflation index : (1995-96 = 281 and 2012-13 = 852)

Answer

Computation of capital gains of Bala for the A.Y.2013-14

Particulars	₹
Deemed sale consideration as per section 50C	13,00,000
Less : Indexed cost of acquisition (₹ 1,50,000 × 852 /281)	<u>4,54,804</u>
Taxable long term capital gain	<u>8,45,196</u>

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 ₹ 7,00,000 received on transfer of land is less than the value of ₹ 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 29

Mr. 'X' furnishes the following data for the previous year ending 31.3.2013:

- (a) Unlisted Equity Shares of AB Ltd., 10,000 in number were sold on 31.5.2012, at ₹ 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 ₹ 50 per share.
 - (ii) Bonus shares received from AB Ltd. on 21.7.1985 (2,000 shares).
 - (iii) Purchased on 1.2.1994 at the price of ₹ 125 per share (3,000 shares).
- (c) Purchased one residential house at ₹ 25 lakhs, on 1.5.2013 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 1993-94: 244; Financial year 2012-13 : 852)

Answer

Computation of taxable capital gain of Mr. 'X' for A.Y. 2013-14

Particulars		₹	₹
Sale consideration received on sale of 10,000 shares @ ₹ 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 x 50 x 852/100	21,30,000	
(b)	2,000 bonus shares received from AB Ltd Bonus shares are acquired on 21.7.1985 (i.e after the year 1980 when the original shares were purchased). Hence, the cost is Nil.	Nil	

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(c)	3000 shares purchased on 1.2.1994 @ ₹ 125 per share. The indexed cost is $3000 \times 125 \times 852/244$	13,09,426	34,39,426
	Long term capital gain		60,574
	Less : Exemption under section 54F (See Note below)		
	₹ 60,574 x ₹ 25,00,000 / ₹ 35,00,000		43,267
	Taxable long term capital gain		17,307

Note:

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

- The assessee should not own more than one residential house on the date of transfer of the long-term capital asset;
- 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.

Question 30

Ms. Vimla sold a residential building at Jodhpur for ₹ 15,00,000 on 01-07-2012.

The building was acquired for ₹ 1,50,000 on 01-06-1997.

She paid brokerage @ 2% at the time of sale of the building. She invested ₹ 7 lakhs in purchase of a residential building in December 2012 and deposited ₹ 2 lakhs in NHA Capital Gains Bond in March, 2013.

Compute her taxable capital gain.

Cost inflation index

1997-98 - 331

2012-13 - 852

Answer**Computation of taxable capital gain of Ms. Vimla for A.Y.2013-14**

Particulars	₹	₹
Sale price of residential building	15,00,000	
Less : Brokerage @ 2%	30,000	
Net consideration		14,70,000
Less : Indexed cost of acquisition		
₹ 1,50,000 x 852/331		3,86,103
		10,83,897

Less: Deduction under section 54 for purchase of new residential house in December 2012		<u>7,00,000</u>
Taxable long term capital gain		<u>3,83,897</u>

Note : One of the conditions for claiming deduction under section 54EC for the investment in RECL/NHAI 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 1.7.2012 and the 6 months period within which the deposit should be made for the purpose of section 54EC would expire by 1.1.2013. The investment in REC/NHAI Capital Gains bonds was made only in March 2013. Therefore, the assessee is not eligible for section 54EC deduction.

Question 31

Mrs. Malini Hari shifted her industrial undertaking located in corporation limits of Faridabad, to a Special Economic Zone (SEZ) on 1.12.2012.

The following particulars are available:

Particulars		₹
(a)	Land: Purchased on 20.01.2003	4,26,000
	Sold for	22,00,000
(b)	Building [Construction completed on 14.03.2005]	
	WDV of building as on 01.04.2012	8,20,000
	Sold for	11,39,000
(c)	WDV of cars as on 01.04.2012	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 25.06.2013):	
	(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 2013-14.

Cost inflation indices are:

Financial year	Index
2002-03	447
2012-13	852

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.

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) Land:**

Sale price	22,00,000
Less: Indexed cost of acquisition $4,26,000 \times 852/447$	<u>8,11,973</u>
Long-term capital gain	<u>13,88,027</u>

(b) Building:

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) Plant:

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 (₹ 3,19,000 – ₹ 1,40,000)	1,79,000
Total capital gain (LTCG+STCG)	
i.e. ₹ 13,88,027 + ₹ 1,79,000	15,67,027

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

Particulars	₹
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 ₹ 15,67,027 or the amount of investment which is ₹ 16,35,000. Hence, the amount of exemption available under section 54GA is ₹ 15,67,027. The taxable capital gains would be Nil.
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 32

Mr. Thomas inherited a house in Jaipur under will of his father in May, 2003. The house was purchased by his father in January, 1980 for ₹ 2,50,000. He invested an amount of ₹ 7,00,000 in construction of one more floor in this house in June, 2005. The house was sold by him in November, 2012 for ₹ 37,50,000. The valuation adopted by the registration authorities for charge of stamp duty was ₹ 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 ₹ 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 ₹ 2,70,000.

You are required to compute the amount of capital gain chargeable to tax for A.Y. 2013-14 with the help of given information and by taking CII for the F.Y. 2003-04 : 463, F.Y. 2005-06 as 497 and for F.Y. 2012-13 as 852.

Answer**Computation of Long term Capital Gain for A.Y. 2013-14**

Particulars	₹	₹
Sale consideration as per section 50C of the Act (Note-I)		47,25,000
Less: Expenses incurred on transfer being brokerage @ 1% of sale consideration of ₹ 37.50 lacs		<u>37,500</u>
		46,87,500

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Less: Indexed cost of acquisition (Note-2) (2,70,000 × 852/463)	4,96,847	
Indexed cost of improvement (7,00,000 × 852/497)	<u>12,00,000</u>	<u>16,96,847</u>
Long term capital gain		<u>29,90,653</u>

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 ₹ 37,50,000

Valuation made by registration authority for stamp duty ₹ 47,25,000

Valuation made by the valuation officer on a reference ₹ 47,50,000

Applying the provisions of section 50C to the present case, ₹ 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.2003-04.

Alternative view: In the case of *CIT v. Manjula J. Shah* 16 Taxmann 42 (Bom.), the Bombay High Court held that the indexed cost of acquisition in case of gifted asset can be computed with reference to the year in which the previous owner first held the asset.

As per this view, the indexation cost of acquisition of house would be ₹ 23,00,400 and long term capital gain would be ₹ 11,87,100.

Question 33

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 34

Ms. Vasumathi purchased 10,000 equity shares of ABC Co. Pvt. Ltd. on 28.2.2005 for ₹ 1,20,000. The company was wound up on 31.7.2012. The following is the summarized financial position of the company as on 31.7.2012:

Liabilities	₹	Assets	₹
60,000 Equity shares	6,00,000	Agricultural lands	42,00,000
General reserve	40,00,000	Cash at bank	6,50,000
Provision for taxation	<u>2,50,000</u>		
	<u>48,50,000</u>		<u>48,50,000</u>

The tax liability (towards dividend distribution tax) was ascertained at ₹ 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 31.7.2012 is ₹ 10,00,000 per acre.

The agricultural land received above was sold by Ms. Vasumathi on 28.2.2013 for ₹ 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

2004-05

480

2012-13

852

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	₹
Ms. Vasumathi holds 1/6 th of the shareholding of the company	
Market value of agricultural land received (1 acre @ ₹ 10 Lakhs)	10,00,000
Cash at bank [1/6 th of (₹ 6,50,000 – ₹ 3,00,000)]	<u>58,333</u>
	10,58,333
Less: Deemed dividend under section 2(22)(c) - 1/6 th of (₹ 40,00,000- ₹ 50,000)	<u>6,58,333</u>
Consideration for computing Capital Gain	4,00,000

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Less: Indexed cost of acquisition of Shares (₹ 1,20,000 x 852/ 480)	<u>2,13,000</u>
Long term capital gains	<u>1,87,000</u>

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	₹
Sale consideration	15,00,000
Less: Fair market value of the agricultural land on the date of distribution	<u>10,00,000</u>
Short term capital gain	<u>5,00,000</u>

2. Dividend under section 2(22)(c) amounting to ₹ 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 ₹ 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 ₹ 3,00,000 has to be reduced from bank balance while computing full value of consideration under section 46(2). ₹ 50,000, being the difference between ₹ 3,00,000 and ₹ 2,50,000, has to be reduced from General Reserve for calculating deemed dividend under section 2(22)(c).

Question 35

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 ₹ 75 lakh arising from transfer of long term capital assets on 1.5.2012 will be exempt from tax if such capital gain is invested in the bonds redeemable after three years, issued by NHAI under section 54EC.
- (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 ₹ 50 lakh during any financial year. Therefore, in this case, the exemption under section 54EC can be availed only to the extent of ₹ 50 lakh, provided the investment is made before 1.11.2012 (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 36

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 ₹ 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 37

Mr. Kumar is the owner of a residential house which was purchased in September, 1993 for ₹ 5,00,000. He sold the said house on 5th August, 2012 for ₹ 24,00,000. Valuation as per stamp valuation authority of the said residential house was ₹ 35,00,000. He invested ₹ 5,00,000 in NHAI Bonds on 12th January, 2013. He purchased a residential house on 5th July, 2013 for ₹ 12,00,000. He gives other particulars as follows:

Interest on Bank Deposit	₹ 32,000
Investment in public provident fund	₹ 50,000

You are requested to calculate the taxable income for the assessment year 2013-14 and the tax liability, if any.

Cost inflation index for F.Y. 1993-94 and 2012-13 are 244 and 852, respectively.

Answer

Computation of total income and tax liability of Mr. Kumar for the A.Y.2013-14

Particulars	₹	₹
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 = $5,00,000 \times 852 / 244$	<u>17,45,902</u>	
	17,54,098	

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Less: Exemption under section 54	₹ 12,00,000		
Exemption under section 54EC	<u>₹ 5,00,000</u>	<u>17,00,000</u>	
Long-term Capital Gain			54,098
Income from other sources:			
Interest on bank deposits			<u>32,000</u>
Gross Total Income			86,098
Less: Deduction under Chapter VI-A			
Section 80C – Investment in PPF (restricted to ₹ 32,000)			<u>32,000</u>
Total Income			54,098
Tax liability			NIL

Notes:

1. The basic exemption limit can be adjusted against long term capital gains, since the entire income comprises of only long term capital gains and is below the basic exemption limit, the tax liability shall be NIL.
2. Deduction under section 80C should be restricted to gross total income excluding long term capital gain.

Question 38

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 39

Mr. Pranav, a resident individual had purchased a plot of land at a cost of ₹ 75,000 in June, 1999. He constructed a house for his residence on that land at a cost of ₹ 1,25,000 in August, 2001. He sold that house in May, 2012 at ₹ 15,00,000 and purchased another residential house in June, 2012 for ₹ 8,00,000. He furnishes other income and investment as follows :

Particulars	₹
Interest on fixed deposit with a bank (Net of TDS ₹ 5,000)	45,000
Investment in PPF	20,000

Cost inflation index for financial year 1999-2000, 2001-02 and 2012-13 are 389, 426 and 852 respectively.

You are required to compute taxable income and tax payable by Mr. Pranav for the assessment year 2013-14.

Answer**Computation of taxable income and tax payable by Mr. Pranav for the A.Y. 2013-14**

	Particulars	₹	₹
1.	Income from Capital Gains		
	Full value of consideration		15,00,000
	Less : Indexed cost of acquisition of land (₹ 75,000 × 852/389)		<u>1,64,267</u>
			13,35,733
	Less : Indexed cost of construction of house (₹ 1,25,000 × 852/426)		<u>2,50,000</u>
			10,85,733
	Less : Deduction under section 54		
	Cost of new residential house		<u>8,00,000</u>
	Long term capital gains		2,85,733
2.	Income from other sources		
	Interest on Bank deposit (Net)	45,000	
	Add : Tax deducted at source	<u>5,000</u>	<u>50,000</u>
	Gross total income		3,35,733
	Less: Deduction under section 80C :		
	Investment in PPF		<u>20,000</u>
	Taxable income		<u>3,15,733</u>
	Components of Total income		
	Special income		
	Long-term Capital gains	2,85,733	
	Normal Income (₹ 50,000 – ₹ 20,000)	<u>30,000</u>	
		<u>3,15,733</u>	

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Tax on normal income of ₹ 30,000	Nil
Tax on LTCG	
[LTCG (Maximum amount not chargeable to tax - Normal Income) @ 20%] under section 112 = {₹ 2,85,733 – (2,00,000 – 30,000)} x 20%	<u>23,147</u>
	23,147
Add : Education cess @ 2%	463
Secondary and higher education cess @ 1%	<u>231</u>
Tax payable	23,841
Less: Tax deducted at source	<u>5,000</u>
	18,841
Tax payable (rounded off)	18,840

EXERCISES

- Distribution of assets at the time of liquidation of a company -*
 - is not a transfer in the hands of the company or the shareholders
 - is not a transfer in the hands of the company but capital gains is chargeable to tax on such distribution in the hands of the shareholders
 - is not a transfer in the hands of the shareholders but capital gains is chargeable to tax on such distribution in the hands of the company.
- For an assessee, who is a salaried employee who invests in shares, what is the benefit available in respect of securities transaction tax paid by him on sale of 100 listed shares of X Ltd. which has been held by him for 14 months before sale?*
 - Rebate under section 88E is allowable in respect of securities transaction tax paid
 - Securities transaction tax paid is treated as expenses of transfer and deducted from sale consideration.
 - Long term capital gains is completely exempt under section 10(38)
- Under section 50C, the guideline value for stamp duty is taken as the full value of consideration only if -*
 - the asset transferred is building and the actual consideration is less than the guideline value
 - the asset transferred is either land or building or both and the actual consideration is less than the guideline value
 - the asset transferred is building, irrespective of the actual consideration.
- When there is a reduction of capital by a company and amounts are distributed to shareholders,*
 - the entire distribution is subject to capital gains tax.
 - the entire distribution is subject to tax under the head "Income from other sources".
 - The distribution attributable to accumulated profits is chargeable as deemed dividend and distribution attributable to capital is subject to capital gains tax.
- Where there is a transfer of a capital asset by a partner to the firm by way of capital contribution or otherwise, the consideration would be taken as -*
 - The market value of the capital asset on the date of transfer

- (b) *The cost less notional depreciation of the capital asset*
- (c) *The value of the asset recorded in the books of the firm.*
- 6. *Under section 54EC, capital gains are exempted if invested in the bonds issued by NHAI & RECL -*
 - (a) *within a period of 6 months from the date of transfer of the asset*
 - (b) *within a period of 6 months from the end of the previous year*
 - (c) *within a period of 6 months from the end of the previous year or the due date for filing the return of income under section 139(1), whichever is earlier*
- 7. *If an assessee receives advance money in any earlier occasion of transfer, which is forfeited, since the transfer eventually did not materialize, then such forfeited amount would be -*
 - (a) *taxable in the year of receipt*
 - (b) *deducted from the cost of acquisition of the asset or fair market value or written down value, as the case may be*
 - (c) *exempt from taxation*
- 8. *Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956 -*
 - (a) *shall be regarded as dividend*
 - (b) *shall not be regarded as dividend but capital gains tax liability is attracted in the hands of the shareholder*
 - (c) *shall neither be regarded as dividend nor will it attract capital gains tax in the hands of the shareholder.*
- 9. *Discuss the conditions to be satisfied for claiming exemption of tax in respect of -*
 - (a) *Capital gains on compulsory acquisition of agricultural land situated within specified urban limits*
 - (b) *Capital gains on sale of listed equity shares/units of an equity oriented fund.*
- 10. *Write short notes on -*
 - (i) *Capital gains in the case of slump sale under section 50B*
 - (ii) *Reference to Valuation Officer under section 55A*
- 11. *What is the tax treatment, under the Income-tax Act, 1961, of capital gains arising on transfer of assets in case of shifting of industrial undertaking from an urban area to any special economic zone? Discuss.*
- 12. *List ten transactions which are not regarded as transfer for the purpose of capital gains. Discuss the provisions relating to the same.*
- 13. *Explain the computation of capital gain in case of depreciable asset under section 50.*
- 14. *What are the transactions not regarded as transfer as per section 47 of the Income-tax Act, 1961?*

Answers

1. b; 2. c; 3. b; 4. c; 5. c; 6. a; 7. b; 8. b

UNIT 5 : Income From Other Sources

Question 1

State whether the following are chargeable to tax and the amount liable to tax :

- (i) A sum of ₹ 1,20,000 was received as gift from non-relatives by Raj on the occasion of the marriage of his son Pravin.
- (ii) Interest on enhanced compensation of ₹ 50,000 was received as per court decree in December 2012 by Mr. Yogesh. Out of the said amount, a sum of ₹ 35,000 relates to preceding financial years.

Answer

S.No.	Taxable/Not Taxable	Amount liable to tax (₹)	Reason
(i)	Taxable	1,20,000	The exemption from applicability of section 56(2)(vii) would be available if, <i>inter alia</i> , gift is received from a relative or gift is received on the occasion of marriage of the individual himself. In this case, since gift is received by Mr. Raj from a non-relative on the occasion of marriage of his son, it would be taxable in his hands under section 56(2)(vii).
(ii)	Taxable	25,000	As per section 56(2)(viii), interest on enhanced compensation is taxable in the year in which it is received. Deduction of 50% in respect of the said income is allowed under section 57(iv). Therefore, ₹ 25,000 (i.e., ₹ 50,000 – ₹ 25,000) is taxable in the hands of Mr. Yogesh in the F.Y.2012-13.

Question 2

On 10.10.2012, Mr. Govind (a bank employee) received ₹ 5,00,000 towards interest on enhanced compensation from State Government in respect of compulsory acquisition of his land effected during the financial year 2007-08.

Out of this interest, ₹ 1,50,000 relates to the financial year 2009-10; ₹ 1,65,000 to the financial year 2010-11; and ₹ 1,85,000 to the financial year 2011-12. He incurred ₹ 50,000 by way of legal expenses to receive the interest on such enhanced compensation.

How much of interest on enhanced compensation would be chargeable to tax for the assessment year 2013-14?

Answer

Section 145A provides that interest received by the assessee on enhanced compensation shall be deemed to be the income of the assessee of the year in which it is received, irrespective of the method of accounting followed by the assessee and irrespective of the financial year to which it relates.

Section 56(2)(viii) states that such income shall be taxable as 'Income from other sources'.

50% of such income shall be allowed as deduction by virtue of section 57(iv) and no other deduction shall be permissible from such Income.

Therefore, legal expenses incurred to receive the interest on enhanced compensation would not be allowed as deduction from such income.

Computation of interest on enhanced compensation taxable as "Income from other sources" for the A.Y 2013-14:

Particulars	₹
Interest on enhanced compensation taxable under section 56(2)(viii)	5,00,000
Less: Deduction under section 57(iv) (50% x 5,00,000)	<u>2,50,000</u>
Taxable interest on enhanced compensation	<u>2,50,000</u>

Question 3

The following details have been furnished by Mrs. Hemali pertaining to the year ended 31.3.2013 :

- (i) *Cash gift of ₹ 51,000 received from her friend on the occasion of her "Shastiaptha Poorthi", a wedding function celebrated on her husband completing 60 years of age. This was also her 25th wedding anniversary.*
- (ii) *On the above occasion, a diamond necklace worth ₹ 2 lacs was presented by her sister living in Dubai.*
- (iii) *When she celebrated her daughter's wedding on 21.2.2013, her friend assigned in Mrs. Hemali's favour, a fixed deposit held by the said friend in a scheduled bank; the value of the fixed deposit and the accrued interest on the said date was ₹ 51,000.*

Compute the income, if any, assessable as income from other sources.

Answer

- (i) Any sum of money received by an individual on the occasion of the marriage of the individual is exempt. This provision is, however, not applicable to a cash gift received during a wedding function celebrated on completion of 60 years of age.

The gift of ₹ 51,000 received from a non-relative is, therefore, chargeable to tax under section 56(2)(vii) in the hands of Mrs. Hemali.

- (ii) The provisions of section 56(2)(vii) are not attracted in respect of any sum of money or property received from a relative. Thus, the gift of diamond necklace received from her sister is not taxable under section 56(2)(vii), even though jewellery falls within the definition of "property".
- (iii) To be exempt from applicability of section 56(2)(vii), the property should be received on the occasion of the marriage of the individual, not that of the individual's son or daughter. Therefore, this exemption provision is not attracted in this case.

Any sum of money received without consideration by an individual is chargeable to tax under section 56(2)(vii), if the aggregate value exceeds ₹ 50,000 in a year. "Sum of money" has, however, not been defined under section 56(2)(vii).

Therefore, there are two possible views in respect of the value of fixed deposit assigned in favour of Mrs. Hemali –

- (1) The first view is that fixed deposit does not fall within the meaning of "sum of money" and therefore, the provisions of section 56(2)(vii) are not attracted. It may be noted that fixed deposit is also not included in the definition of "property".
- (2) However, another possible view is that fixed deposit assigned in favour of Mrs. Hemali falls within the meaning of "sum of money" received.

Income assessable as "Income from other sources"

If the first view is taken, the total amount chargeable to tax as "Income from other sources" would be ₹ 51,000, being cash gift received from a friend on her Shastipatha Poorthi.

As per the second view, the provisions of section 56(2)(vii) would be attracted in respect of the fixed deposit assigned and the "Income from other sources" of Mrs. Hemali would be ₹ 1,02,000 (₹ 51,000 + ₹ 51,000).

Question 4

Decide the following transactions in the context of Income-tax Act, 1961 :

- (i) *Mr. B transferred 500 shares of Reliance Industries Ltd. to M/s. B Co. (P) Ltd. on 10.10.2012 for ₹ 3,00,000 when the market price was ₹ 5,00,000. The indexed cost of acquisition of shares for Mr. B was computed at ₹ 4,45,000. The transfer was not subjected to securities transaction tax.*

Determine the income chargeable to tax in the hands of Mr. B and M/s. B Co. (P) Ltd. because of the above said transaction.

- (ii) *Mr. Chezian is employed in a company with taxable salary income of ₹ 5,00,000. He received a cash gift of ₹ 1,00,000 from Atma Charitable Trust (registered under section 12AA) in December 2012 for meeting his medical expenses.*

Is the cash gift so received from the trust chargeable to tax in the hands of Mr. Chezian?

Answer

- (i) Transfer of shares without consideration or for inadequate consideration would attract the provisions of section 56(2)(viiia), if the recipient is a firm or a company. The purpose of this provision is to prevent the practice of transferring unlisted shares at prices much below the fair market value.

The provisions of section 56(2)(viiia) would, however, not be attracted in the case of, *inter alia*, transfer of shares of a company in which public are substantially interested. In this case, the shares of Reliance Industries Ltd. are transferred. Since Reliance Industries Ltd. is a company in which public are substantially interested, the provisions of section 56(2)(viiia) would not be attracted in the hands of M/s. B Co. (P) Ltd.

The indexed cost of acquisition (₹ 4,45,000) less the actual sale consideration (₹ 3,00,000) would result in a long term capital loss of ₹ 1,45,000 in the hands of Mr. B, which is eligible for set off against any other long term capital gain.

- (ii) The provisions of section 56(2)(vii) would not apply to any sum of money or any property received from any trust or institution registered under section 12AA. Therefore, the cash gift of ₹ 1 lakh received from Atma Charitable Trust, being a trust registered under section 12AA, for meeting medical expenses would not be chargeable to tax under section 56(2)(vii) in the hands of Mr. Chezian.

Question 5

Rahul holding 28% of equity shares in a company took a loan of ₹ 5,00,000 from the same company. On the date of granting the loan, the company had accumulated profit of ₹ 4,00,000. The company is engaged in some manufacturing activity.

- (i) *Is the amount of loan taxable as deemed dividend in the hands of Rahul, if the company is a company in which the public are substantially interested?*
- (ii) *What would be your answer, if the lending company is a private limited company (i.e. a company in which the public are not substantially interested)?*

Answer

Any payment by a company, other than a company in which the public are substantially interested, of any sum by way of advance or loan to an equity shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power, is deemed as dividend under section 2(22)(e), to the extent the company possesses accumulated profits.

- (i) The provisions of section 2(22)(e), however, will not apply where the loan is given by a company in which public are substantially interested. In such a case, the loan would not be taxable as deemed dividend in the hands of Rahul.

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- (ii) However, if the loan is taken from a private company (i.e. a company in which the public are not substantially interested), which is a manufacturing company and not a company where lending of money is a substantial part of the business of the company, then, the provisions of section 2(22)(e) would be attracted, since Rahul holds more than 10% of the equity shares in the company.

The amount chargeable as deemed dividend cannot, however, exceed the accumulated profits held by the company on the date of giving the loan. Therefore, the amount taxable as deemed dividend in the hands of Rahul would be limited to the accumulated profit i.e., ₹ 4,00,000 and not the amount of loan which is ₹ 5,00,000.

Question 6

From the following particulars of Pankaj for the previous year ended 31st March, 2013, compute the income chargeable under the head "Income from other sources":

Sl. No.	Particulars	₹
(i)	Directors fee from a company	10,000
(ii)	Interest on bank deposits	3,000
(iii)	Income from undisclosed source	12,000
(iv)	Winnings from lotteries (Net)	35,000
(v)	Royalty on a book written by him	9,000
(vi)	Lectures in seminars	5,000
(vii)	Interest on loan given to a relative	7,000
(viii)	Interest on debentures of a company (listed in a recognised stock exchange) net of taxes	3,600
(ix)	Interest on Post Office Savings Bank Account	500
(x)	Interest on Government Securities	2,200
(xi)	Interest on Monthly Income Scheme of Post Office	33,000

He paid ₹ 1,000 for typing the manuscript of book written by him.

Answer

Computation of income of Pankaj chargeable under the head "Income from other sources" for the A.Y. 2013-14

Particulars	₹	₹
1. Directors' fees		10,000
2. Interest on bank deposit		3,000
3. Income from undisclosed source		12,000

4. Royalty on books written (See Note below)	9,000	
Less: expenses	<u>1,000</u>	8,000
5. Lectures in seminars		5,000
6. Interest on loan given to a relative		7,000
7. Interest on listed debentures		
Net Received	3,600	
Add: T.D.S. @ 10%		
$\frac{3600 \times 10}{100 - 10}$	<u>400</u>	4,000
8. Interest on Post Office Savings Bank [exempt under section 10(15)]		-
9. Interest on Government securities		2,200
10. Interest on Post Office Monthly Income Scheme		33,000
11. Winnings from lotteries		
Net	35,000	
Add: T.D.S. @ 30% $\frac{35,000 \times 30}{100 - 30}$	<u>15,000</u>	
		<u>50,000</u>
Income from Other Sources		<u>1,34,200</u>

Note – Royalty income would be charged to tax under the head “Income from Other Sources”, only if it is not chargeable to tax under the head “Profits and gains of business or profession”. This problem has been solved assuming that the same is not taxable under the head “Profits and gains of business or profession” and hence, is chargeable to tax under the head “Income from other sources”.

Question 7

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

- (i) Rakesh received ₹ 70,000 from his friend on the occasion of his birthday.
- The entire amount of ₹ 70,000 is taxable
 - ₹ 20,000 is taxable
 - The entire amount is exempt
 - 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 ₹ 3,00,000
 - (b) Exempt upto ₹ 3,50,000
 - (c) Totally exempt under section 10(19)
 - (d) Totally chargeable to tax
- (iii) Gift of ₹ 5,00,000 received on 10th July, 2012 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 ₹ 50,000 and balance chargeable to tax as income from other sources.

Answer

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

Question 8

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

"A" receives ₹ 2 lakh from his friends on the occasion of his marriage on 22.12.2012 and ₹ 1 lakh from the brother of his father-in-law on 31.12.2012. A's income includible under "other sources" for the previous year 2012-13 would be ₹ 3 lakh.

Answer

False : As per section 56(2)(vii), 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 ₹ 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, ₹ 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, ₹ 1 lakh is taxable under the head "Income from other sources".

The statement that ₹ 3 lakh is includible in A's income is, therefore, false.

Question 9

Check the taxability of the following gifts received by Mrs. Rashmi during the previous year 2012-13 and compute the taxable income from gifts for Assessment Year 2013-14:

- (i) On the occasion of her marriage on 14.8.2012, she has received ₹ 90,000 as gift out of which ₹ 70,000 are from relatives and balance from friends.
- (ii) On 12.9.2012, she has received gift of ₹ 18,000 from cousin of her mother.
- (iii) A cell phone worth ₹ 21,000 is gifted by her friend on 15.8.2012.
- (iv) She gets a cash gift of ₹ 25,000 from the elder brother of her husband's grandfather on 25.10.2012.
- (v) She has received a cash gift of ₹ 12,000 from her friend on 14.4.2012.

Answer**Computation of taxable income of Mrs. Rashmi from gifts for A.Y.2013-14**

Sl. No.	Particulars	Taxable amount (₹)	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	Nil	Cell phone is not included in the definition of property as per <i>Explanation</i> to section 56(2)(vii). 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	<u>12,000</u>	Cash gift from friend is taxable.
	Aggregate value of gifts	<u>55,000</u>	

Since the sum of money received by Mrs. Rashmi without consideration during the previous year 2012-13 exceeds ₹ 50,000, the whole of the amount is chargeable to tax under section 56(2)(vii) of the Income-tax Act, 1961.

Question 10

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) 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 11

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.

EXERCISES

1. *Income from letting of machinery, plant and furniture is -*
 - a) *always chargeable to tax under the head "Profits and gains of business and profession"*
 - b) *always chargeable to tax under the head "Income from other sources"*
 - c) *chargeable under the head "Income from other sources" only if not chargeable under the head "Profits and gains of business and profession".*
2. *In respect of winnings from lottery, crossword puzzle or race including horse race or card game etc.*
 - a) *no deduction under Chapter VI-A is allowed and basic exemption limit cannot be exhausted.*

- b) no deduction under Chapter VI-A but unexhausted basic exemption can be exhausted.
 - c) Both deduction under Chapter VI-A and basic exemption are allowed.
3. The deduction allowable in respect of family pension taxable under "Income from other sources" is
- a) 33-1/3% of the pension
 - b) 30% of the pension or ₹ 15,000, whichever is less
 - c) 33-1/3% of the pension or ₹ 15,000, whichever is less
4. Deemed dividend under section 2(22)(e) is chargeable to tax -
- a) On the basis of method of accounting regularly employed by the assessee
 - b) On the basis of mercantile system of accounting only
 - c) On payment basis as prescribed under section 8 of the Income-tax Act, 1961.
5. Ganesh received ₹ 60,000 from his friend on the occasion of his birthday.
- a) The entire amount of ₹ 60,000 is taxable.
 - b) ₹ 25,000 is taxable.
 - c) The entire amount is exempt.
6. Write short notes on -
- a) Bond washing transactions
 - b) Dividend stripping
7. State the incomes which are chargeable only under the head "Income from other sources".
8. Which are incomes chargeable under the head "Income from other sources" only if they are not chargeable under the head "Profits and gains of business or profession"?
9. What are the deductions allowable from the following income -
- a) Dividend
 - b) Income from letting on hire machinery, plant or furniture.
10. What are the inadmissible deductions while computing income under the head "Income from other sources".
11. Karan's bank account shows the following deposits during the financial year 2012-13. Compute his total income for the A.Y. 2013-14, assuming that his income from house property (computed) is ₹ 62,000.
- (i) Gift from his sister in Amsterdam ₹ 2,30,000

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(ii) Gift from his friend on his birthday	₹ 10,000
(iii) Dividend from shares of various Indian companies	₹ 12,600
(iv) Gift from his mother's friend on his engagement	₹ 25,000
(v) Gift from his fiancée	₹ 75,000
(vi) Interest on bank deposits (Fixed Deposit)	₹ 25,000

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

Answers

1. c; 2. a; 3. c; 4. c; 5. A; 11. ₹ 1,97,000