INCOME TAX LAW & PRACTICE

(CBCS in Accordance with NEP 2020)

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CONTENTS **PAGE**

Unit 1: Basic Concepts and Key Definitions under the Income Tax Act

Definition (Sec.2) Assessee, Assessment Year, Previous Year, Income, Person, Capital Assets; Agricultural Income; Capital and Revenue Receipts & Expenditure; Incomes which do not form part of total income; Residential status of Individuals: HUF, Firms, Companies, Resident, Non-resident, Not ordinarily resident Incidence of tax based on residential status; Scope of total income; Place of accrual and receipt of income.

Unit 2: Exempted Income (Sec. 10)

Specific exemptions for individuals: allowances, perquisites, scholarships, Exemptions for trusts, political parties, charitable institutions, Partial vs. fully exempt incomes, Practical problems.

Unit 3: Tax Planning

Concept, Tax planning for a new business/ existing business; Tax avoidance and Tax evasion: Meaning and difference; Tax Management; Filing of return; Tax Deduction at Source; Advance Payment of Tax; Tax Planning for individuals (Salaried persons/ assessee) in practical context.

Unit 4: Heads of Income under Income Tax Act

Salaries: Meaning and features of salary, Allowances (HRA, DA, TA, etc.), Perquisites and tax treatment, Profits in lieu of salary, Retirement benefits (gratuity, pension, leave encashment, PF), Computation of taxable salary.

Unit 5: Computation of Income from House Property

Basis of charge – Annual Value, Self-occupied vs. let-out properties, Determination of GAV, NAV, Deductions under Sec. 24(a) & 24(b), Computation problems.

Unit 6: Profits and Gains of Business or Profession

Meaning of business and profession, Allowed and disallowed expenses, Depreciation – rules & rates, Book profit vs. taxable profit, Presumptive taxation (Sec. 44AD, 44ADA, 44AE), Computation of business/professional income.

Unit 7: Capital Gains

Meaning of capital asset, Long-term vs. short-term capital assets, Indexed cost of acquisition/improvement; Exemptions: Sec. 54, 54B, 54EC, 54F, Special cases: slump sale, bonus shares, rights shares, Computation of capital gains.

Unit 8: Income from Other Sources

Residual head of income**,** Casual income**,** Dividend income, interest income**,** Gifts and taxation under Sec. 56(2)(x)**,** Computation of income.

Unit 9: Clubbing of Income & Set-off and Carry Forward of Losses

Clubbing of Income (Sec. 60–64);

Transfer of income without transfer of asset, Minor child income, Spousal clubbing, Clubbing in HUF. Set-off & Carry forward; Intra-head and inter-head adjustments, Treatment of business losses, capital losses, house property losses.

Unit 10: Deductions under Chapter VI-A

Deductions under Sec. 80C, 80CCC, 80CCD, 80D, 80DD, 80DDB, 80TTA, 80TTB, 80G, 80E, 80EEA, 80GGC, etc., Computation of total income after deductions.

Unit 11: Tax Computation, Rebate, Relief & Marginal Relief

Gross Total Income → Total Income → Tax Liability; Rates of tax for individuals, HUF, firm, company; Surcharge, Health & Education Cess; Rebate under Sec. 87A, Relief under Sec. 89, Marginal relief.

Unit 12: Assessment Procedure

Types of assessment: Self-assessment, Summary assessment, Scrutiny assessment, Best judgment assessment, Re-assessment; Return of income: filing, due dates, belated and revised returns; PAN, TAN, Aadhaar–PAN linking, Defective return.

Unit 13: Tax Deducted at Source (TDS), Tax Collected at Source (TCS), & Advance Tax

TDS: Concept, applicability, rates, compliance, TDS on salary, interest, contractors, rent, professional fees.
TCS: Items covered, rates, compliance.
Advance Tax: Liability, due dates, calculation, Interest for defaults (Sec. 234A/B/C).

Unit 14: Appeals, Penalties, Prosecution & Recent Developments

Appeals & Revision: Appellate hierarchy: CIT(A), ITAT, High Court, Supreme Court, Rectification of mistakes, Revision by CIT.
Penalties & Prosecution: Penalties for failure to file return, misreporting, under-reporting.
Recent Developments: Faceless assessment, E-filing & pre-filled returns, New Tax Regime vs. Old Tax Regime (optional topic), Latest amendments of the Finance Act (overview).

COURSE INTRODUCTION

This course provides a comprehensive understanding of the Income Tax Act, 1961, focusing on the principles, provisions, and practical application of income taxation in India. It is designed to equip learners with conceptual clarity as well as computational skills required for determining taxable income under various heads, understanding exemptions and deductions, and complying with tax procedures. The course also highlights important aspects such as tax planning, assessment procedures, and recent developments in the taxation system, enabling learners to apply theoretical knowledge to real-life situations.

Unit 1: Basic Concepts and Key Definitions under the Income Tax Act

This unit explains the fundamental definitions and concepts such as assessee, assessment year, previous year, income, person, and capital assets. It also covers agricultural income, capital and revenue receipts, exempt incomes, and residential status along with its impact on tax liability. This unit builds the foundation for understanding the scope and applicability of income tax.

Unit 2: Exempted Income (Sec. 10)

This unit explains the various incomes that are exempt from tax under Section 10. It includes exemptions available to individuals, trusts, and institutions, along with partial and full exemptions. Practical problems are also discussed to enhance understanding of the application of exemptions.

Unit 3: Tax Planning

This unit explains the concept and importance of tax planning for individuals and businesses. It distinguishes between tax planning, tax avoidance, and tax evasion, and covers aspects like tax management, filing of returns, TDS, and advance tax. It provides practical insights into minimizing tax liability within legal boundaries.

Unit 4: Heads of Income under Income Tax Act (Salaries)

This unit explains the concept of salary and its components, including allowances, perquisites, and retirement benefits. It focuses on the computation of taxable salary and the treatment of various elements of salary income.

Unit 5: Computation of Income from House Property

This unit explains the method of computing income from house property. It covers concepts like annual value, self-occupied and let-out properties, and deductions under relevant sections, along with practical computation problems.

Unit 6: Profits and Gains of Business or Profession

This unit explains the taxation of business and professional income. It includes allowable and disallowable expenses, depreciation rules, and presumptive taxation schemes. The unit focuses on the computation of taxable business income.

Unit 7: Capital Gains

This unit explains the concept of capital assets and capital gains, distinguishing between short-term and long-term gains. It also covers indexation, exemptions under various sections, and computation methods for capital gains.

Unit 8: Income from Other Sources
This unit explains the residual head of income covering incomes not included under other heads. It includes casual income, dividends, interest, and gifts, along with their tax treatment and computation.

Unit 9: Clubbing of Income & Set-off and Carry Forward of Losses
This unit explains the provisions relating to clubbing of income and adjustments of losses. It covers intra-head and inter-head set-offs, carry forward of losses, and specific cases like minor and spousal income.

Unit 10: Deductions under Chapter VI-A
This unit explains the various deductions available under Chapter VI-A to reduce taxable income. It includes deductions for investments, insurance, medical expenses, education loans, and donations, along with their computation.

Unit 11: Tax Computation, Rebate, Relief & Marginal Relief
This unit explains the process of computing tax liability from gross total income to net tax payable. It includes tax rates, surcharge, cess, rebates, and relief provisions applicable to different taxpayers.

Unit 12: Assessment Procedure
This unit explains the procedures involved in assessment under the Income Tax Act. It covers types of assessments, filing of returns, due dates, and compliance requirements including PAN and Aadhaar linkage.

Unit 13: Tax Deducted at Source (TDS), TCS & Advance Tax
This unit explains the concepts and provisions related to TDS, TCS, and advance tax. It covers their applicability, rates, compliance requirements, and consequences of default.

Unit 14: Appeals, Penalties, Prosecution & Recent Developments
This unit explains the appellate system, penalties, and prosecution provisions under income tax law. It also highlights recent developments such as faceless assessment, e-filing, and changes introduced by recent Finance Acts.

Each unit includes some alongside boxes to help you know some of the difficult, unseen terms. Some “EXERCISES” have been included to help you apply your own thoughts. You may find some boxes marked with: “LET US KNOW”. These boxes will provide you with some additional interesting and relevant information. Again, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your progress of study. It will be helpful for you if you solve the problems put in these boxes immediately after you go through the sections of the units and then match your answers with “ANSWERS TO CHECK YOUR PROGRESS” given at the end of each unit.

UNIT 1: BASIC CONCEPTS AND KEY DEFINITIONS UNDER THE INCOME TAX ACT

UNIT STRUCTURE

1.1 Learning Objectives

1.2 Introduction

1.3 Key Definitions and Concepts under the Income Tax Act

- 1.3.1 Income
- 1.3.2 Capital Assets
- 1.3.3 Agricultural Income
- 1.3.4 Capital and Revenue Receipts
- 1.3.5 Capital and Revenue Expenditure

1.4 Incomes which do not form part of total income

1.5 Residential Status

- 1.5.1 Residential Status of Individuals
- 1.5.2 Residential Status of HUFs
- 1.5.3 Residential Status of Firms
- 1.5.4 Residential Status of Companies

1.6 Scope of Total Income

1.7 Place of accrual and receipt of Income.

1.8 Let Us Sum Up

1.9 Further Reading

1.10 Answers To Check Your Progress

1.11 Model Questions

1.1 LEARNING OBJECTIVES

After going through this unit, you will able to:

- define and explain key terms viz. income, agricultural income, capital assets as used in the Act.
- illustrate the meaning of capital and revenue receipts and expenditures
- Identify categories of income which do not form part of total income.
- Understand the concept of residential status of individuals, Hindu Undivided Families (HUFs), firms, and companies.
- Understand the scope of total income.
- Comprehend the significance of the place of accrual and receipt of income

1.2 INTRODUCTION

In order to have a meaningful study of income tax law, we need to have a thorough understanding of its foundational definitions and concepts. This unit introduces five key definitional concepts — Income, Capital Assets, Agricultural Income, Capital and Revenue Receipts, and Capital and Revenue Expenditure — and then proceeds to examine the critically important topics of Residential Status and the Scope of Total Income. Together, these concepts form the bedrock upon which the entire structure of income tax liability in India rests.

1.3 KEY DEFINITIONS AND CONCEPTS UNDER THE INCOME TAX ACT

The Income Tax Act, 1961 defines several terms in Section 2 that carry specific legal meanings, which may differ from their common everyday usage. In order to understand the provisions of the Act, we must have a thorough knowledge of the meanings of these definitions. We have already covered some of the important definitions in Unit 5 of Course-01. In this Unit we shall cover a few more important terms defined under section 2 of the Income Tax Act, 1961.

1.3.1 Income

Income Tax is charged on the income earned by an assessee during the financial year. Section 2(24) of the Income Tax Act, 1961 has defined the term “Income” providing an inclusive list of incomes for the purpose of the Act. Any receipt which comes withinthe scope of Section 2(24) is considered as income and the receiveris taxed on that amount. Income, in common parlance, means a periodical monetary receipt/ return coming in with some sort of regularity and from definite source. Income tax, as the word itself signifies, is a tax on income. But the Act does not adequately definethe term 'income'. Its meaning is more or less similar to the layman'sunderstanding of its being equal to money or money's worth periodically received from a definite source. It may be taken to denoteanything which comes in and that too, from some outside source. Income may be received in cash or in kind which is equivalent to cash. Wherever an assessee earns an income, he/she is taxed on such income.

Section 2(24) of the Act gives a statutory definition of

income. At present, the following items of receipts are specifically included in income:—

(1) Profits and gains;

(2) Dividends;

(3) Voluntary contributions received by a trust/ institution created wholly or partly for charitable or religious purposes or by an association or institution referred to in section 10(21) or by a fund or institution referred to in section 10(23C) (iiiad)/ (iiiae)/ (iv)/(v)/(vi)/(via) or an electoral trust;

(4) The value of any perquisite or profit in lieu of salary taxable under section 17(2) and (3), respectively;

(5) Any special allowance or benefit, other than the perquisite included above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit;

(6) Any allowance granted to the assessee to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living;

(7) The value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;

(8) The value of any benefit or perquisite, whether convertible into money or not, which is obtained by any representative assessee mentioned under section 160(1)(iii) and (iv), or by any beneficiary or any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay;

(9) Deemed profits chargeable to tax under section 41 or section 59;

(10) Profits and gains of business or profession chargeable to tax under section 28;

(11) Any capital gains chargeable under section 45;

(12) The profits and gains of any insurance business carried on by Mutual Insurance Company or by a cooperative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of the provisions contained in the first Schedule to the Act;

(13) The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with

its members;
(14) Any winnings from lotteries, cross-word puzzles, races including horse races, card games and other games of any sort or from gambling, or betting of any form or nature whatsoever.
(15) Any sum received by the assessee from his employees as contributions to any provident fund (PF) or superannuation fund or Employees State Insurance Fund (ESI) or any other fund for the welfare of such employees;
(16) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy will constitute income;
(17) Any sum referred to in section 28(va).
(18) Fair market value of inventory as on the date on which it is converted into, or treated as, a capital asset, determined in the prescribed manner [Section 28(iva)];
(19) Any consideration received for issue of shares as exceeds the fair market value of the shares [Section 56(2)(viib)];
(20) Any sum of money received as advance, if such sum is forfeited consequent to failure of negotiation for transfer of a capital asset [Section 56(2)(ix)];
(21) Any sum of money or value of property received without consideration or for inadequate consideration by any person [Section 56(2)(x)];
(22) Any compensation or other payment, due to or received by any person, by whatever named called, in connection with termination of his employment or the modification of the term and conditions relating thereto [Section 56(2)(xi)];
(23) Assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement, by whatever name called, by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee is included in the definition of income.
(24) Any specified sum received by a unit holder from a business trust during the previous year, with respect to a unit held by him at any time during the previous year [Section 56(2)(xii)]
(25) Sum received, including the amount allocated by way of bonus, under a LIP other than under a ULIP and keyman insurance policy, which is not exempt u/s 10(10D), to the extent the same exceeds the aggregate of the premium paid during the term of the policy, and not claimed as deduction under any other provision of the Act [Section 56(2)(xiii)]

1.3.2 Capital Assets

According to section 2(14), a capital asset means –

(a) property of any kind held by an assessee, whether or not connected with his business or profession;

(b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the SEBI regulations.

(c) any unit linked insurance policy (ULIP) issued on or after 1.2.2021, to which exemption under section 10(10D) does not apply on account of applicability of the fourth and fifth provisos thereof.

However, it does not include—

(i) Stock-in trade: Any stock-in-trade [other than securities referred to in (b) above], consumable stores or raw materials held for the purpose of the business or profession of the assessee;

Whether a particular asset is stock-in-trade or capital asset does not depend upon the nature of the item, but the manner in which the same is held. The item would be stock-in trade in the hands of the assessee who deals or trades in that item; however, the same item would be capital asset for the assessee who holds it as an investment.

(ii) Personal effects: Personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him.

EXCLUSIONS:

(a) jewellery;
(b) archaeological collections;
(c) drawings;
(d) paintings;
(e) sculptures; or
(f) any work of art.

(iii) Rural agricultural land in India i.e., agricultural land in India which is not situated in any specified area.

1.3.3 Agricultural Income

Section 2(1A) of the Income Tax Act, 1961 defines Agricultural Income. As per the definition, Agricultural Income means:

(a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes.

(b) Any income derived from such land by agriculture operations including processing of agricultural produce so as to render it fit for the market or sale of such produce.

(c) Any income attributable to a farm house subject to satisfaction of certain conditions specified in this regard in section 2(1A). Also, any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

The above definition of agricultural income is very wide and covers the income of not only the cultivators but also the land holders who might have rented out the lands. Agricultural income may be received in cash or in kind.

In reference to taxability to agricultural income, Section 10(1) of the Income Tax Act, 1961 provides that agricultural income is not to be included in the total income of the assesse. Thus, agricultural income is exempt from the levy of tax. The reason for totally exempting agricultural income from the scope of Income Tax is that under the Constitution, the Central Government has no power to levy a tax on agricultural income.

1.3.4 Capital and Revenue Recipts

Income-tax is a tax on income and not a tax on every item of money received. Capital receipts cannot be taxed, unless they fall within the scope of the definition of “income” and so the distinction between capital and revenue receipts is of fundamental importance for tax purposes. However, some capital receipts have been specifically included in the definition of income. There is no universal rule to categorize a particular receipt is capital or revenue in nature. Hence, the capital or revenue nature of the receipt must be determined with reference to the facts and circumstances of each case.

(a) <u>Revenue Receipts</u>

Revenue receipts arise from the normal course of business or employment or from the use of capital assets. They represent the income generated by the capital, not a return of the capital itself. Examples include:

- Sale proceeds of trading goods (stock-in-trade).
- Professional fees, salary, and wages.
- Rent received from letting out property.
- Interest on loans and deposits.
- Commission, brokerage, and agency income.

(b) Capital Receipts

Capital receipts arise from transactions involving capital assets — their sale, surrender, or destruction. They represent a change in the form of capital rather than a return on it. Examples include:

- Sale proceeds of a fixed asset (land, building, plant, machinery).
- Amount received for sterilisation of a capital asset (permanent loss of use).
- Compensation received for the cancellation or termination of a capital trading advantage.
- Premium on issue of shares (share capital).
- Subsidy or grant received for capital purposes (acquisition of fixed asset).

1.3.5 Capital and Revenue Expenditure

Alike the capital and revenue receipts, understanding the distinction between capital and revenue expenditure is equally significant, since only revenue expenditure is deductible against business income unless specifically disallowed in the Act. Capital expenditure, by contrast, is not directly deductible unless it is specifically allowed under the provisions of the Act.

(a) Revenue Expenditure

Revenue expenditure is incurred in the ordinary course of carrying on a business or profession. It is recurring in nature and does not create a durable or long-term benefit beyond the current accounting period. Its purpose is to maintain the profit-earning apparatus, not to acquire or improve it. Examples include:

- Salaries, wages, and employee benefits.
- Rent, rates, and insurance for business premises.
- Cost of raw materials and consumable stores.
- Advertising and marketing expenditure (routine).
- Repairs and maintenance of existing plant and machinery.
- Interest on borrowed capital used for business purposes.

(b) Capital Expenditure

Capital expenditure is incurred to acquire, improve, or create a long-term asset or advantage for the business. It is typically non-recurring, creates an enduring benefit extending beyond the current accounting year, and forms part of the fixed capital of the business. Examples include:

- Purchase of plant, machinery, furniture, and fixtures.
- Construction of or improvement to factory buildings.
- Acquisition of patents, trademarks, and copyrights.
- One-time payments for acquiring exclusive distribution rights.
- Preliminary expenses incurred for setting up a company.
- Expenditure on substantial modification or overhaul of machinery that significantly extends its useful life.

1.4 INCOME WHICH DO NOT FORM OF TOTAL INCOME

There are certain incomes upon which a taxpayer need not pay any tax as per provisions of the Income Tax Act. Such incomesare called Exempted Incomes or Tax Free Incomes.

Exempted Incomes or Tax-free incomes are covered under Section 10 of theIncome Tax Act. In order to claim exemption under this section, it isthe duty of the assessee to prove that an item of receipt falls withinthe exempted category.

The important incomes which are exempted from income tax are listed below:

1. Agricultural income,
2. Income received by a member of the Hindu Undivided Family either out of the income of the H.U.F. or out of the income of the estate belonging to the H.U.F.

3. Share of income of a partner in the total income of the firm, which is separately assessed to tax.
4. The following types of interest received by a non-resident-
   (i) Interest on such securities or bonds as the Central Government may specify in this behalf.
   (ii) Interest on deposits standing in a Non-Resident (External) Account in any bank in India.
   (iii) Interest on certain notified savings certificates, such as National Savings Certificate.
5. Income of a foreign company by way of fees for technical services received in pursuance of an agreement entered into with the Central Government for providing services in India or outside India in projects connected with security of India.
6. Death-cum Retirement Gratuity is exempt from tax subject to the conditions and extent stated in that section.
7. Commuted pension is exempt from tax subject to the conditions and extent stated in that section.
8. Encashment earned leave received by an employee is exempt from tax subject to the conditions and extent stated in that section.
9. Retrenchment compensation received by an employee is exempt from tax subject to the conditions and extent stated in that section.
10. Compensation received by any victim of Bhopal Gas Leak Disaster.
11. Any lump sum received by an employee who has completed 10 years of service or completed 45 years of age on voluntary retirement.
12. Any sum received under a life insurance policy including the sum allocated by way of bonus on such policy except the amount received under an insurance policy, if the premium payable does not exceed 20% of the actual capital sum assured.

13. Refund from the statutory provident fund received by an employee.
14. Refund or payment from a recognised provident fund received by an employee with certain conditions.
15. House rent allowance received by an employee subject to certain limit and subject to the conditions and extent stated in that section.
16. Special allowances are exempt from tax subject to the conditions and extent stated in that section.
17. Interest, premium or bonus on certain specified securities and deposits subject to the conditions and extent stated in that section or as defined by the Central Government.
18. Scholarship granted to meet the cost of education.
19. Daily allowances received by MPs, MLAs and MLCs and other allowances received by MPs.
20. Literary, scientific and artistic work and other awards instituted by the Central Government or by any State Government.
21. Pension received by an individual who has been in the service of the Central or State Government and has been awarded "Param Vir Chakra" or "Maha Vir Chakra" or "Vir Chakra" or such other gallantry award as the Central Government may, by notification in the official gazette, specify in this behalf, and (ii) family pension received by any member of the family of such individual as referred to in clause(i), will be exempt from tax with effect from 1-4-2000.
22. As per Section 10 (19) of the Income Tax Act, family pension received by the widow or children or nominated heirs, as the case may be, of a member of the armed forces (including para military forces) of the Union, where the death of such member has occurred in the course of operational duties, in such circumstances and subject to such conditions as prescribed with effect from 1-4-2005.

23. As per Section 10 (19A) of the Income Tax Act, the annual value of any one place in the occupation of former ruler of an Indian State is exempt from tax.
24. As per Section 10 (20) of the Income Tax Act, income of a local authority which is chargeable under the head (i) Income from House Property or (ii) Capital Gains or (iii) Income from Other Sources or (iv) income from a business carried on by it which accrues or arises from the supply of commodities or services (not being water or electricity) within its jurisdiction or from the supply of water or electricity within or outside its jurisdiction is fully exempt from tax.
25. From the assessment year 1999-2000, under Section 10 (23C), the income of an educational institution existing for educational purposes, and not for the purpose of earning profits, is exempt from tax.
26. The income of hospitals and other medical institutions existing solely for philanthropic purposes, and not for purposes of profit, is exempt from tax under Section 10 (23C).
27. As per Section 10 (23A) of the Income Tax Act, income of professional institutes like the Indian Medical Association is exempt from tax.
28. As per Section 10 (23BBA) of the Income Tax Act, income of any authority established for the administration of any public religious or charitable trusts or endowments (including mutts, temples, wakfs, churches, gurudwaras) is exempt from Income Tax.
29. As per Section 10 (23D) of the Income Tax Act, income of a notified mutual fund set up by a public sector bank or a public sector financial institution or authorised by the Securities and Exchange Board of India or the Reserve Bank of India, such as the State Bank of India Mutual Fund, Canara Bank Mutual Fund, the Punjab National Bank Mutual Fund the LIC Mutual Fund and the General Insurance Corporation Mutual Fund, etc. is exempt from tax.

30. As per Section 10 (23AAB) of the Income Tax Act, any income of a fund set up by the LIC on or after 1.8.1996 under pension fund scheme to which contribution is made by any person for receiving pension from such fund, and which is approved by the Controller of Insurance, is exempt from tax.
31. As per Section 10 (26) of the Income Tax Act, any income of a member of a scheduled tribe residing in any area specified in this behalf, if it is earned from any source in that area or income received by way of dividend or interest on securities, even if it arises from a source in areas not specified above, is exempt from tax.
32. As per section 13A of the Income Tax Act, any income of political parties, duly registered, falling under the head "Income from house property" or "Income from other sources" or voluntary contributions received by them from any persons are exempt from income tax subject to the fulfilment of the following conditions:
    (a) The political party is registered, with the Election Commission of India.
    (b) It should keep and maintain proper books of account and other documents as would enable the assessing officer to properly deduce income.
    (c) Its accounts should be audited by a qualified chartered accountant.
    (d) It should keep proper records of persons, as to their names and addresses, who have made voluntary contributions exceeding Rs. 20,000.
33. Income of certain specified national charitable funds, such as the Prime Minister's National Relief Fund, the Prime Minister's Fund (Promotion of Folk Art), the Prime Minister's Aid to Students Fund, the National Foundation for Communal Harmony or any other charitable fund notified by the Government of India is exempt from tax.

34. Income of trade unions, registered under the Trade Unions Act of 1926, viz., income from house property, and income from other sources is exempt from tax.
35. As per Section 10 (32) of the Income Tax Act, if the income of an individual includes the income of his minor child, he can claim exemption upto Rs. 1,500 in respect of each minor child's income, provided the income of the minor child included in the income of the individual exceeds Rs. 1,500.
36. The income of notified news agency set up in India solely for collection and distribution of news is exempt from income tax, provided the following conditions are satisfied:
    (i) The news agency applies its income solely for collection and distribution of news.
    (ii) It does not distribute its income in any manner among its members.
37. Income of housing authorities like State Housing Boards or other statutory authorities set up for the purpose of meeting the need for housing accommodation or for the purpose of planning and development of cities, towns and villages is exempt from tax.
38. Any income derived by a statutory marketing authority from the letting of godowns or warehouses for storage, processing or for facilitating the marketing of commodities is exempt from tax.
39. Income of Khadi and Village Industries Board set up under the State or Provincial Act is exempt from tax.
40. As per Section 10 (21) of the Income Tax Act, any income of an approved scientific research association is exempt from tax, provided its income is applied solely for its purpose.
41. Any income of a venture capital company or venture capital fund set up to raise funds of investment in venture capital undertakings is exempt from tax under Section 10 (23B) of the Income Tax Act with effect from the assessment year 2000-01.

42. Any income of a corporation established by the Central or State Government for promoting the interest of the members of the minority community as notified is exempt from tax.
43. Any income of a corporation established by government or a body wholly financed by the government for promoting the interests of the members of Scheduled Castes or Scheduled Tribes or Other Backward Classes or any of them is exempt from tax.
44. As per Section 10 (23G) of the Income Tax Act, income by way of dividends, interest or long-term capital gains of any Infrastructure Capital Fund or Infrastructure Capital Company is exempt from tax.
45. As per Section 10 (30) of the Income Tax Act, if an assessee engaged in the business of growing and manufacturing tea in India, receives any subsidy from the Tea Board under a notified scheme for replantation or replacement for tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea in India is exempt from tax.
46. As per Section 10 (31) of the Income Tax Act, subsidy received by an assessee engaged in the business of growing and manufacturing rubber, coffee, cardamom or such other plantation crops as may be notified by the central Government is exempt from tax, provided the subsidy is received from the concerned Board, it (i.e., the subsidy) is used for re-plantation or replacement of rubber plants, coffee plants or cardamom plants or for rejuvenation or consolidation of areas, and the assessee furnishes to the assessing officer, along with the return of income, a certificate from the concerned Board stating the amount of subsidy received during the previous year.
47. As per Section 10 (34) of the Income Tax Act, dividend income referred to in Section 115-0 of the Income Tax Act, received from a domestic company (i.e., Indian Company) which has declared, distributed or paid the dividend on or after 1.4.2003

is exempt from tax with effect from the assessment year 2004-05.

48. As per Section 10 (35) of the Income Tax Act, income received from the units of Unit Trust of India, and the income received from the units of mutual funds specified under Section 10 (23D) of the Income Tax Act are exempt from tax with effect from the assessment year 2004-05.
49. As per Section 10 (38) of the Income Tax Act, long term capital gains on transfer of equity shares or units of equity oriented mutual fund is not chargeable to tax from the assessment year 2005-06 if such transaction is covered by Securities Transaction Tax.



CHECK YOUR PROGRESS

Q 1: Income is defined under section…….of the Income Tax Act, 1961

Q 2: Define the terms-

i) Capital Asset ii) Agricultural Income

a) ……

1.5 RESIDENTIAL STATUS

The concept of Residential status in the Income Tax Law is important as it determines the scope of chargeability of income of a person. Whether a person will be charged to a particular income or not, depends on his residential status. Thus, determining the residential status of a person is essential for calculating tax liability of a person. Section 5 of the Income Tax Act states that the total income of any previous year of a person who is a resident includes all income from whatever source derived. Section 6 of the Income Tax Act prescribes the criteria to determine the residential status of all tax payers for purposes of income-tax. For all purposes of income-tax, the Act classifies all taxpayers into three broad categories on the basis of their residential status viz.

(1) Resident and ordinarily resident
(2) Resident but not ordinarily resident
(3) Non-resident

The residential status of an assessee must be ascertained with reference to each previous year. A person who is resident and ordinarily resident in one year may become non-resident or resident but not ordinarily resident in another year or vice versa.
The concept of residential status must not be confused with an individual's citizenship in India as both are two different concept. An individual may be a citizen of India but may not be a resident for a particular previous year. Similarly, a foreign citizen may be a resident of India for the purpose of income tax for a particular previous year.
In the upcoming sections we shall discuss the provisions for determining the residential status of different categories of persons.

1.5.1 RESIDENTIAL STATUS OF INDIVIDUALS

The residential status of an individual for a previous year is determined on the basis of his physical presence in India during that year and, in certain cases, in preceding years.
Under section 6(1), an individual is said to be resident in India in any previous year, if he satisfies any one of the following conditions:
(1) He has been in India during the previous year for a total period of 182 days or more, or
(2) He has been in India for a total period of 60 days or more during the previous year and for 365 or more days during 4 previous years immediately preceding the relevant previous year.
If the individual satisfies any one of the conditions mentioned above, he is a resident. If both the above conditions are not satisfied, the individual is a non-resident.

Exception to the basic condition:
The 60-day threshold in condition (2) is increased to 182 days for:
(a) an Indian citizen who leaves India during the previous year for employment outside India or as a member of the crew of an Indian ship, and

(b) an Indian citizen or a person of Indian origin (PIO) who comes on a visit to India during the previous year (from outside India).
This effectively means such individuals need to be in India for at least 182 days to be treated as resident.

Deemed resident [Section 6(1A)] – An individual, being an Indian citizen, having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (except income from a business controlled from or profession set up in India) and which is not deemed to accrue or arise in India], exceeding Rs. 15 lakhs during the previous year would be deemed to be resident in India in that previous year, if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.
However, this provision will not apply in case of an individual who is a resident of India in the previous year as per section 6(1).

Resident and ordinarily resident/Resident but not ordinarily resident

Only individuals and HUF can be "resident but not ordinarily resident" in India. All other classes of assessees can be either a resident or non-resident. A not ordinarily resident person is one who satisfies any one of the conditions specified u/s 6(6).

(i) If such individual has been non-resident in India in any 9 out of the 10 previous years preceding the relevant previous year, or
(ii) If such individual has, during the 7 previous years preceding the relevant previous year, been in India for a period of 729 days or less, or
(iii) If such individual is an Indian citizen or person of Indian origin (who, being outside India, comes on a visit to India in any previous year) having total income, other than the income from foreign sources [i.e., income which accrues or arises outside India (other than income derived from a business controlled in or profession set up in India) and which is not deemed to accrue or arise in India], exceeding Rs 15 lakhs during the previous year, who has been in India for 120 days or more but less than 182 days during that previous year, or
(iv) If such individual is an Indian citizen who is deemed

to be resident in India under section 6(1A) [It may be noted that a deemed resident will always be a resident but not ordinarily resident].

1.5.2 RESIDENTIAL STATUS OF HUFs

A Hindu Undivided Family is a unique entity recognised under Hindu personal law and the Income Tax Act. It comprises all persons lineally descended from a common ancestor, including their wives and unmarried daughters. The **Karta** is the manager and head of a HUF and all other members are called **Coparceners.** For tax purposes, a HUF is treated as a separate taxable entity.

Resident: A HUF would be resident in India if the control and management of its affairs is situated wholly or partly in India.

Non-resident: If the control and management of the affairs is situated wholly outside India, it would become a non-resident.

Resident and ordinarily resident/Resident but not ordinarily resident

If Karta of resident HUF satisfies both the following additional conditions (as applicable in case of individual) then, resident HUF will be resident and ordinarily resident, otherwise it will be resident but not ordinarily resident.

1) Karta of resident HUF should be resident in at least 2 previous years out of 10 previous years immediately preceding relevant previous year.
2) Stay of Karta during 7 previous years immediately preceding relevant previous year should be 730 days or more.

1.5.3 RESIDENTIAL STATUS OF FIRMS

The residential status of a firm, whether a partnership firm or a Limited Liability Partnership (LLP), is determined by the same principle that governs HUFs: the location of control and

management.
Resident: A firm would be resident in India if the control and management of its affairs is situated wholly or partly in India.
Non-resident: Where the control and management of the affairs is situated wholly outside India, the firm would become a non-resident.

1.5.4 RESIDENTIAL STATUS OF COMPANIES

The test for determining residential status of a company was significantly amended by the Finance Act, 2016, which introduced the concept of 'Place of Effective Management' (POEM) as an additional criterion. Prior to this amendment, a foreign company could avoid Indian residence status by simply incorporating abroad and holding board meetings outside India.
A company would be resident in India in any previous year, if-

(i) it is an Indian company; or
(ii) its place of effective management, in that year, is in India.

POEM is defined as the place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made. This concept is borrowed from international tax treaties (OECD Model Convention) and is intended to prevent companies from claiming foreign residency while actually being managed from India.

Foreign companies that are managed entirely from abroad (board meetings held abroad, key decisions made abroad) are treated as Non-Resident. Only their India-source income is taxable in India.



CHECK YOUR PROGRESS

Q 3: State the three broad categories into which all the taxpayers are classified on the basis of their residential status.

1.6 SCOPE OF TOTAL INCOME

Section 5 provides the scope of total income in terms of the residential status of the assessee because the incidence of tax on any person depends upon his residential status. The scope of total income of an assessee depends upon the following three important considerations:

(i) the residential status of the assessee;
(ii) the place of accrual or receipt of income, whether actual or deemed; and
(iii) the point of time at which the income had accrued to or was received by or on behalf of the assessee.

The ambit of total income of the three classes of assessees would be as follows:

(1) Resident and ordinarily resident

The total income of a resident assessee would, under section 5(1), consist of:

(i) income received or deemed to be received in India during the previous year;

(ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year; and
(iii) income which accrues or arises outside India even if it is not received or brought into India during the previous year.

In simpler terms, a resident and ordinarily resident has to pay tax on the total income accrued or deemed to accrue, received or deemed to be received in or outside India during the relevant previous year.

(2) **Resident but Not Ordinarily Resident In India**

Proviso to section (1) of section 5 the total income in case of resident but not ordinarily resident in India

(i) income received or deemed to be received in India during the accounting year by or on behalf of such person;
(ii) income which accrues or arises or is deemed to accrue or arise to him in India during the accounting year;
(iii) income which accrues or arises to him outside India during the previous year if it is derived from a business controlled in or a profession set up in India.

(3) **Non-Resident**

Sub-section (2) of Section 5 provides that the total income of a non-resident would comprise of :

(i) income received or deemed to be received in India in the accounting year by or on behalf of such person;
(ii) income which accrues or arises or is deemed to accrue or arise to him in India during the previous year.

A tabular presentation of the nature of income and the provision of tax incidence on the basis of Residential Status is provided below.

Source / Nature of Income	**Resident and Oridnarily Resident (ROR)**	**Resident but not Oridnarily Resident (RNOR)**	**Non- Resident (NR)**
Income received or deemed to be received in India during the previous year	Taxable	Taxable	Taxable
Income accruing or arising in India or deemed to accrue or arise in India during the previous year	Taxable	Taxable	Taxable
Income accruing or arising outside	Taxable	Taxable	Not Taxable

India from a business controlled in India or profession set up in India			
Income accruing or arising outside India – From Business controlled from or Professional setup outside India	Taxable	Not Taxable	Not Taxable
Remittances into India	Not Taxable	Not Taxable	Not Taxable

1.7 PLACE OF ACCRUAL AND RECEIPT OF INCOME

Income is 'received' in India when it is actually received at a place in India or is directly credited to an Indian bank account. Income 'accrues' when the assessee acquires a present right to receive it — the actual receipt may come later. The place of accrual is typically where the services are rendered, the business is carried on, or the property is situated.

All assessees are liable to tax in respect of the income received or deemed to be received by them in India during the previous year irrespective of –

(i) their residential status, and

(ii) the place of its accrual.

Income is to be included in the total income of the assessee immediately on its actual or deemed receipt.

Section 9 deals with income that is deemed to accrue or arise in India even though they may actually accrue or arise outside India. This section is particularly important for non-residents and foreign companies, as it defines the circumstances in which income that originates from activities or assets connected with India is treated as having an Indian source and is therefore taxable in India. Income, which arises outside India because of business connection (or Professional connection) in India is deemed to accrue or arise in India (subject to certain exceptions) and shall be taxable in hands of all assessee irrespective of his residential status. Income deemed to accrue or arise in India includes:

1. Income from any business connection in India.

2. Income from any property, asset, or source of income in India.
3. Income from the transfer of a capital asset situate in India.
4. Salary for services rendered in India (even if paid abroad).
5. Salary payable by the Government of India to an Indian citizen for services rendered outside India.
6. Dividend paid by an Indian company outside India.
7. Interest paid by a resident in India to a non-resident (subject to exceptions).
8. Royalties and fees for technical services payable by a resident or by a non-resident for services used in India.

1.8 LET US SUM UP

This unit has introduced the foundational definitions and concepts that govern income taxation in India under the Income Tax Act, 1961. In this unit we have discussed the following:

- The Income Tax Act, 1961 is the principal legislation governing income tax in India.
- 'Income' is inclusively defined and goes beyond salaries and profits to include dividends, capital gains, lottery winnings, and more.
- Capital assets include all forms of property except stock-in-trade and rural agricultural land.
- Agricultural income from land in India is fully exempt but may affect the tax rate applicable on non-agricultural income under partial integration rules.
- Capital receipts are generally not taxable as income; capital expenditure is not fully deductible in the year of incurrence.
- Section 9 deems certain foreign-origin incomes to arise in India, thereby taxing non-residents on India-connected income.The present Income Tax Act came into existence in 1961.
- Residential Status [Section 6]: Determined afresh for each previous year on the basis of physical presence in India (individuals) or control and management (HUF, firm, company). Three categories for individuals: ROR, RNOR, NR.

- Scope of Total Income [Section 5]: ROR is taxed on global income; RNOR on India-sourced income and India-controlled business income; NR only on India-received or India-accrued income.



1.9 FURTHER READING

- Singhania, V.K. & Singhania, M. — Students' Guide to Income Tax (Taxmann Publications) — Latest Edition
- Ahuja, G.K. & Gupta, R. — Systematic Approach to Income Tax (Bharat Law House) — Latest Edition
- Pagare, Dinkar — Law and Practice of Income Tax (Sultan Chand & Sons) — Latest Edition
- Income Tax Act, 1961 — Bare Act (Government of India)
- CBDT Circulars and Notifications — Available at: www.incometaxindia.gov.in
- e-Filing Portal for practical understanding of return filing: www.incometax.gov.in

1.10 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: Sec 2(24)

Ans to Q No 2: (i) According to section 2(14), a capital asset means –

(a) property of any kind held by an assessee, whether or not connected with his business or profession;

(b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the SEBI regulations.

(c) any unit linked insurance policy (ULIP) issued on or after 1.2.2021, to which exemption under section 10(10D) does not apply on account of applicability of the fourth and fifth provisos thereof.

(ii) Section 2(1A) of the Income Tax Act, 1961 defines Agricultural Income. As per the definition, Agricultural Income means:

(a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes.

(b) Any income derived from such land by agriculture operations including processing of agricultural produce so as to render it fit for the market or sale of such produce.

(c) Any income attributable to a farm house subject to satisfaction of certain conditions specified in this regard in section 2(1A). Also, any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

Ans to Q No 3: For all purposes of income-tax, the Act classifies all taxpayers into three broad categories on the basis of their residential status viz.

(1) Resident and ordinarily resident

(2) Resident but not ordinarily resident

(3) Non-resident

1.11 MODEL QUESTIONS

Q 1: What is a capital asset? Name any four items that are excluded from the definition of capital assets.

Q2: What is agricultural income? Give two examples of agricultural income and two examples of income that appears to be agricultural but is NOT exempt.

Q3: Explain in detail the concept of Residential Status of an Individual under the Income Tax Act. How does residential status determine the scope of total income?

Q4: Distinguish between (a) Capital and Revenue Receipts, and (b) Capital and Revenue Expenditure, with examples. Why is this distinction important in income tax?

Q5: Explain the scope of total income under Section 5 for Resident and Ordinarily Resident (ROR), Resident but Not Ordinarily Resident (RNOR), and Non-Resident (NR) taxpayers.

Q6: What are the incomes deemed to accrue or arise in India under Section 9?

Q7: Write a note on the residential status of (a) HUF, (b) Firms, and (c) Companies under the Income Tax Act.

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UNIT 2: EXEMPTED INCOME

UNIT STRUCTURE

2.1 Learning Objectives
2.2 Introduction
2.3 Fully Exempted Incomes
2.4 Partially Exempted Incomes
2.5 Fully Exempted Incomes vs Partially Exempted Incomes
2.6 Specific Exemptions for Individuals

- 2.6.1 Allowances
- 2.6.2 Perquisites
- 2.6.3 Scholarships and Awards

2.7 Exemptions for Trusts
2.8 Exemption for Political Parties
2.9 Exemptions for Charitable Institutions
2.10 Let Us Sum Up
2.11 Further Reading
2.12 Answers To Check Your Progress
2.13 Model Questions

2.1 LEARNING OBJECTIVES

After studying this unit, you will be able to:

1. Understand the concept of exempted income and its legal basis under Section 10 of the Income Tax Act, 1961.
2. Classify the fully exempted incomes and partially exempted incomes and distinguish between them.
3. Identify and explain the major categories of income exempt from tax applicable to individuals.
4. Understand the tax exemptions available to trusts and charitable institutions under the Act.
5. Identify the specific tax treatment of income of political parties.

2.2 INTRODUCTION

In the preceding unit, we have learned that income tax islevied on incomes earned during the assessment year. We have also learnt that tax is imposed on the basis of the residential statusof the assessee. But it is not that an assessee is required to pay taxon all the incomes. Some incomes are exempt from income tax under the various provisions of the Income Tax Act. Such incomesare called Exempted Incomes. Exempted Incomes are covered under Section 10 of the Income Tax Act. In order to claim exemption under this section, it isthe duty of the assessee to prove that an item of receipt falls withinthe exempted category. In this unit, we shall discuss the concept of exempted income and its legal basis under Section 10 of the Income Tax Act, 1961.

We shall also discuss the various classes of exempted incomes and understand the differences between them. Further, the major categories of income exempt from tax applicable to individuals shall be discussed. We shall also understand the tax exemptions available to trusts, charitable institutions and political parties.

2.3 FULLY EXEMPTED INCOMES

Fully exempted incomes are those that are completely excluded from the purview of total income, regardless of the quantum of receipt. No tax is payable on them, and they are not even considered for rate-determination purposes (except agricultural income under the partial integration rules). The following are the major categories of fully exempted income:

(i) Agricultural Income [Section 10(1)]

Any income derived from agricultural land in India — whether as rent, revenue, or direct profit from cultivation — is fully exempt. As discussed in Unit 1, agricultural income from land outside India is not exempt.

(ii) Receipts by a Member from a Hindu Undivided Family (HUF) [Section 10(2)]

Any sum received by an individual as a member of a HUF, out of the income of the HUF, is fully exempt in the hands of the member. This prevents double taxation, since the HUF is separately taxed on its own income.

(iii) Share of Profit from a Partnership Firm [Section 10(2A)]

A partner's share in the profit of a firm is fully exempt in the hands of the partner. The firm is separately taxed on its profits. This again prevents double taxation. Note: Any salary, bonus, commission, or remuneration paid by the firm to a working partner is NOT exempt — it is taxable as 'Profits and Gains of Business or Profession' in the partner's hands.

(iv) Interest Received by a Non-Resident on Notified Securities/Bonds [Section 10(4)]

Interest on certain notified securities and bonds received by a non-resident (or a person who is not ordinarily resident) is fully exempt. The government notifies specific bonds (such as NRI bonds, infrastructure bonds) for this purpose to attract foreign investment.

(v) Leave Travel Concession / Assistance (LTC/LTA) [Section 10(5)]

The value of any travel concession or assistance received by an employee from his employer — for himself and his family — for journeys performed on leave to any place in India is exempt, subject to prescribed conditions and limits. (This is discussed in detail under Section 2.6.1 on Allowances.)

(vi) Remuneration Received by Foreign Diplomats and Officials [Section 10(6)]

Remuneration received by individuals who are not citizens of India and who are officials of foreign governments or embassies (such as ambassadors, high commissioners, consuls, trade commissioners) is fully exempt, provided equivalent exemption is extended to Indian officials in that country (principle of reciprocity).

(vii) Allowances or Perquisites Outside India [Section 10(7)]

Any allowance or perquisite paid or allowed outside India by the Government of India to a citizen of India for rendering service outside India is fully exempt.

(viii) Death-cum-Retirement Gratuity [Section 10(10)]

Gratuity received by an employee on retirement or by the family/nominee on the death of an employee is exempt as follows:

- Government employees: Entire gratuity is exempt — no limit.
- Non-government employees covered under the Payment of Gratuity Act, 1972: Exempt up to Rs. 20 lakh.
- Other non-government employees: Least of the following three is exempt:
  - Rs. 20 lakh;
  - Actual gratuity received;

  15 days' salary (based on last drawn salary) for each completed year of service.

(ix) Commuted Pension [Section 10(10A)]

Commuted pension (i.e., lump sum received in lieu of periodic pension by surrendering a portion of it) is exempt as follows:

- Government employees: Entire commuted pension is exempt.
- Non-government employees who also receive gratuity: 1/3rd of the full value of commuted pension is exempt.

  Non-government employees who do not receive gratuity: 1/2 of the full value of commuted pension is exempt.

(x) Leave Encashment [Section 10(10AA)]

Leave encashment is the amount received by an employee for unutilised earned leave at the time of retirement or resignation.

- Government employees: Entire leave encashment at retirement is exempt.
- Non-government employees: Exempt up to Rs. 25 lakh (enhanced by the Finance Act 2023 from the earlier Rs. 3 lakh).
- Leave encashment received while still in service (not at retirement) is fully taxable.

(xi) Retrenchment Compensation [Section 10(10B)]

Compensation received by a workman under the Industrial Disputes Act, 1947 at the time of retrenchment is exempt up to:

- Rs. 5,00,000; or
- An amount calculated in accordance with the Industrial Disputes Act formula (15 days' average pay for each completed year of service); whichever is lower.

(xii) Voluntary Retirement Scheme (VRS) Compensation [Section 10(10C)]

Compensation received by an employee of a public sector company, statutory authority, or specified entity under a Voluntary Retirement Scheme (VRS or 'golden handshake') is exempt up to Rs. 5,00,000. The VRS must comply with prescribed guidelines.

(xiii) Life Insurance Proceeds [Section 10(10D)]

Any sum received under a Life Insurance Policy (LIP), including bonus, on maturity or on the death of the insured, is fully exempt from tax, subject to the following conditions:

- For policies issued on or after 1st April 2003: The annual premium paid must not exceed 20% of the sum assured.
- For policies issued on or after 1st April 2012: The premium must not exceed 10% of the sum assured.
- For policies issued on or after 1st April 2023: If the aggregate annual premium exceeds Rs. 5 lakh, the maturity proceeds are taxable (except in case of death).
- Death claims are ALWAYS fully exempt, regardless of the premium amount.

(xiv) PPF, Sukanya Samriddhi and Similar Scheme Receipts [Section 10(11) & 10(11A)]

Any payment (including interest) from the Public Provident Fund (PPF), Sukanya Samriddhi Account, or other recognised provident funds on maturity is fully exempt. PPF enjoys the EEE (Exempt-Exempt-Exempt) status — contributions are deductible, interest is exempt, and maturity proceeds are exempt.

(xv) Payment from Statutory and Recognised Provident Funds [Section 10(12)]

The accumulated balance payable to an employee from a Recognised Provident Fund is exempt to the extent provided in Rule 8 of the Fourth Schedule — generally if the employee has rendered continuous service of 5 years or more. Payments from statutory PF are always exempt.

(xvi) Income of Scheduled Tribe Members [Section 10(26)]

Any income accruing or arising to a member of a Scheduled Tribe from any source in specified States (Manipur, Mizoram, Nagaland, Tripura, Arunachal Pradesh, Meghalaya, Sikkim) or in areas specified by the Central Government is fully exempt. This is an important provision particularly relevant to the North-East Indian context.

(xvii) Income of Certain Institutions [Section 10(20), 10(23C)]

The following entities enjoy full exemption on their income:

- Local authorities — on all income excluding business income [Section 10(20)].
- Universities, educational institutions, hospitals, and medical institutions approved under Section 10(23C) — on income applied solely for educational or charitable purposes.

  Religious and charitable trusts registered under Section 12A/12AA/12AB — on income applied for approved purposes.

2.4 PARTIALLY EXEMPTED INCOMES

Partially exempted incomes are those where only a certain portion of the receipt is exempt from tax — the balance remains taxable. The exempt portion is determined by prescribed formulas, limits, or percentages. These are especially common in the context of salaried employees.

(i) House Rent Allowance (HRA) [Section 10(13A)]

HRA received by an employee who lives in a rented house is partially exempt. The exempt portion is the LEAST of the following three:

- Actual HRA received from employer.
- Rent paid minus 10% of Basic Salary.
- 50% of Basic Salary (for employees residing in metro cities — Delhi, Mumbai, Chennai, Kolkata) OR 40% of Basic Salary (for employees in non-metro cities).

(ii) Special Allowances [Section 10(14)]

Many allowances granted by employers are partially exempt under Section 10(14), to the extent they are actually spent for the purpose for which they are granted. These include:

Allowance	Exempt Amount	Condition
Children's Education Allowance	Rs. 100 per month per child (up to 2 children)	For tuition fees of own children
Children's Hostel Expenditure Allowance	Rs. 300 per month per child (up to 2 children)	Child residing in hostel
Transport Allowance (for disabled employees)	Rs. 3,200 per month	For employees who are blind or orthopedically handicapped
Tribal Area Allowance	Up to Rs. 200 per month	Employees in tribal areas of specified states
Underground Mine Allowance	Up to Rs. 800 per month	Mine workers working underground
High Altitude Allowance	Rs. 1,060 – Rs. 1,600 per month	Armed forces personnel at high altitude postings
Daily Allowance on tour/transfer	Actual expenditure for purpose	Must be spent on official travel/transfer
Helper/Research/Uniform Allowance	Actual expenditure for purpose	Allowance must be spent for intended purpose

(iii) Gratuity (Partial Exemption for Non-Government Employees)

Gratuity for non-government employees is partially exempt — only the amount computed under the prescribed formula is exempt; the excess is taxable.

(iv) Pension (Partial Exemption on Commutation)

Commuted pension is partially exempt for non-government employees (1/3rd or 1/2 of full value, depending on whether gratuity is also received). Periodic/uncommuted pension is fully taxable.

(v) Voluntary Donations to Charitable Institutions [Section 80G]

While not under Section 10, donations to specified charitable institutions attract 50% or 100% deductions under Section 80G. However, to the extent the institution itself (the recipient) is exempt, contributions received by it are its fully exempt income.

2.5 FULLY EXEMPTED INCOMES VS PARTIALLY EXEMPTED INCOMES

The table below summarises the key differences between fully and partially exempted incomes:

No.	Fully Exempted Incomes	Partially Exempted Incomes
1	Entire amount is excluded from total income — nothing is taxable.	Only a prescribed portion is excluded; the balance is included in total income and taxed.
2	No formula or limit calculation required.	Requires calculation of exempt portion using formulas, limits, or actual expenditure.
3	Examples: Agricultural income, HUF distribution, share of firm profit, PPF interest, LIC proceeds (within conditions).	Examples: HRA, LTA, gratuity (non-government employees), commuted pension, special allowances.
4	Generally no compliance burden specific to exemption (though reporting may be required).	Often requires the employee/taxpayer to maintain bills, receipts, or declarations to claim the exempt portion.
5	Agricultural income, though fully exempt, is considered for rate purposes under partial integration.	The taxable portion is added to total income and taxed at applicable slab rates.

2.6 SPECIFIC EXEMPTIONS FOR INDIVIDUALS

Working professionals and salaried employees are entitled to several specific exemptions that directly reduce their tax burden. These broadly fall into three categories: Allowances, Perquisites, and Scholarships/Awards.

2.6.1 Allowances

Allowances are fixed monetary amounts paid by an employer to an employee over and above the basic salary, to meet specific expenses. For tax purposes, allowances are broadly classified as:

- Fully Taxable Allowances — e.g., Dearness Allowance (DA), City Compensatory Allowance (CCA), Overtime Allowance, Warden's Allowance, Lunch Allowance.
- Fully Exempt Allowances — e.g., allowances paid to UN employees, allowances to Judges of High Courts and Supreme Court.
- Partially Exempt Allowances — e.g., House Rent Allowance, Leave Travel Allowance, special allowances under Section 10(14).

2.6.2 Perquisites

A 'perquisite' is any casual emolument, fee, or profit attached to an office or position in addition to salary or wages. Perquisites are broadly of two types:

- Taxable perquisites: Included in the salary income of the employee and taxed accordingly.
- Exempt perquisites: Not included in salary income and hence not taxed.

The following perquisites are EXEMPT from tax in the hands of employees:

Exempt Perquisite	**Conditions / Limits**
Free medical treatment / reimbursement	Treatment in government hospital or employer's own hospital: fully exempt. In private hospitals: exempt up to Rs. 15,000 per year.
Medical facility outside India	Expenditure on treatment and travel (for self and accompanying attendant) permitted by RBI is exempt.
Accommodation in remote areas / project sites	Free accommodation provided by employer at a remote location (no urban facility) is exempt.
Employer's contribution to recognised PF/NPS	Employer's contribution to Recognised PF up to 12% of salary and NPS up to 10% of salary is exempt.
Interest-free or concessional loans	Exempt if aggregate loan amount does not exceed Rs. 20,000, OR if loan is for medical treatment of specified diseases.
Food and beverages in office	Free food/beverages provided during working hours in the office (up to Rs. 50 per meal) is exempt.
Laptop / computer provided for official use	Laptop or computer provided by the employer for official use is fully exempt.
Telephone / Mobile phone for official use	Mobile phone or telephone connection provided for official purposes is exempt.
Gifts and vouchers	Gifts in kind (not cash) from employer up to Rs. 5,000 per year are exempt.

Recreational facilities	Use of health club, sports facilities provided uniformly to all employees at employer's premises is exempt.
Transfer / relocation expenses	Actual cost of transfer — moving household effects, travel expenses — paid by employer is exempt.

2.6.3 Scholarships and Awards [Section 10(16) and Section 10(17A)]

The following receipts in the nature of scholarships and awards are fully exempt:

Scholarships [Section 10(16)]

Any scholarship granted to meet the cost of education is fully exempt from tax, regardless of the amount. This includes scholarships from:

- The Central or State Government.
- Universities, educational institutions, boards.
- Private organisations and corporates (e.g., merit scholarships).
- Foreign governments or organisations.

Awards and Rewards [Section 10(17A)]

Any award instituted in the public interest by the Central or State Government, or approved by the Central Government, received by an individual is fully exempt. Examples include:

- Bharat Ratna, Padma Vibhushan, Padma Bhushan, Padma Shri and other civilian awards.
- Arjuna Award, Dronacharya Award, Rajiv Gandhi Khel Ratna Award.
- Bravery awards, gallantry awards.
- Scientific, literary, or artistic awards recognised by the government.

CHECK YOUR PROGRESS — I

1. State whether True or False:

(a) A partner's share in firm profits is taxable in the partner's hands.

(b) Uncommuted pension is fully exempt from tax.

(c) HRA exemption is available even if the employee owns the house they live in.

(d) A scholarship of Rs. 5 lakh from a private company is fully exempt.

2. Mention any three incomes that are fully exempt from tax in the hands of an individual assessee.

2.7 EXEMPTIONS FOR TRUSTS

A trust is a legal arrangement where property is held by one party (the trustee) for the benefit of another (the beneficiary). Trusts in India that are established for charitable or religious purposes and are registered with the Income Tax Department enjoy significant tax exemptions.

Under Section 11, a registered charitable/religious trust is exempt from tax on:

1. Income from property held under trust for charitable or religious purposes to the extent it is applied for such purposes in India.
2. Voluntary contributions received, treated as income applied for the purpose of the trust.
3. Accumulation of up to 15% of income (i.e., a trust can 'save' up to 15% of income without spending it in the same year and still claim exemption on it).
4. Additional accumulation beyond 15% is permitted for up to 5 years under Section 11(2), if the trust files Form 10 specifying the purpose for which the amount is being accumulated.

The conditions for Claiming Exemption are:

- The trust must be registered under Section 12AB.
- Income must be applied for charitable/religious purposes in India.
- The books of accounts must be maintained and audited (if income exceeds Rs. 2.5 lakh).
- The trust must file its income tax return.
- Anonymous donations exceeding certain limits are taxable at 30%.
- Political donations are not considered charitable — exempt status is not available for amounts donated to political parties or for political activity.

2.8 EXEMPTION FOR POLITICAL PARTIES

A registered political party in India enjoys a special and unique tax exemption. Under Section 13A, any income of a political party — from house property, capital gains, other sources, or voluntary contributions received from any person — is fully exempt from income tax, provided the following conditions are satisfied:

1. The political party must be registered under Section 29A of the Representation of the People Act, 1951.
2. The party must maintain books of accounts and other documents to enable the Assessing Officer to properly deduce its income from them.
3. The party must maintain a record of each voluntary contribution of Rs. 20,000 or more, along with the name and address of the contributor.
4. The accounts of the political party must be audited by a Chartered Accountant.
5. The treasurer of the party must submit a report to the Election Commission of India on contributions received exceeding Rs. 20,000.
6. The party must file its income tax return within the prescribed due date.

2.9 EXEMPTIONS FOR CHARITABLE INSTITUTIONS

Charitable institutions in India broadly fall into two regulatory tracks under the Income Tax Act — those governed by Section 10(23C) and those under Sections 11–13. Both provide tax exemptions, but the eligibility, registration mechanism, and compliance requirements differ.

The following charitable institutions are covered under Section 10(23C):

- Institutions wholly or substantially financed by the government:- **Income is fully exempt without any approval requirement.**
- Universities and educational institutions existing solely for education and not for profit: **Exempt if annual receipts do not exceed Rs. 5 crore.**
- Hospitals and medical institutions existing solely for philanthropic purposes: **Exempt if annual receipts do not exceed Rs. 5 crore.**
- Other educational institutions and hospitals with receipts above Rs. 5 crore: **Require specific approval from the Principal Commissioner or Commissioner of Income Tax.**

Regardless of whether the charitable institution is governed by Section 10(23C) or Sections 11-13, the following are points are critical for availing exemptions:

1. **Application of Income:** Income must be applied for the stated charitable/religious purpose. 'Applied' means actually spent — mere resolution or commitment is insufficient.
2. **Corpus Donations:** Donations made specifically to the corpus (permanent fund) of the trust are not treated as income of the trust, provided they are invested in specified securities.
3. **Anonymous Donations [Section 115BBC]:** Any anonymous donation (where donor's identity is not disclosed) received by a charitable institution (other than religious trust) in excess of 5% of total donations received or Rs. 1 lakh (whichever is higher) is taxable at 30%.
4. **Foreign Contributions:** Most charitable institutions cannot receive foreign contributions without registration under the Foreign Contribution (Regulation) Act, 2010 (FCRA). FCRA registration is separate from income tax registration.
5. **Related Party Transactions [Section 13]:** If any income or property of the trust is used for the benefit of the author, trustee, or their relatives, the trust loses its exemption for that year.

CHECK YOUR PROGRESS — II

3. What are the conditions a political party must fulfil to claim exemption under Section 13A?

4. What is an anonymous donation? How is it treated under the Income Tax Act?

2.10 LET US SUM UP

This unit has covered a broad spectrum of exempted incomes under the Income Tax Act, 1961. In this unit we have discussed the following:

- Exempted incomes under Section 10 are excluded from the computation of total income.
- Fully exempted incomes include agricultural income, HUF distributions, partner's share of profit, PPF/Sukanya Samriddhi receipts, LIC proceeds (subject to conditions), gratuity of government employees, commuted pension of government employees, and income of Scheduled Tribe members in notified North-East areas.
- Partially exempted incomes include HRA, LTA, gratuity of non-government employees, commuted pension of non-government employees, and various special allowances — where only the lower of prescribed limits or actual amounts is exempt.
- HRA exemption is calculated as the least of: (i) actual HRA received, (ii) rent paid minus 10% of basic salary, and (iii) 50%/40% of basic salary for metro/non-metro cities.
- Scholarships are fully exempt under Section 10(16); government-approved awards and gallantry awards are exempt under Section 10(17A).
- Charitable and religious trusts registered under Section 12AB enjoy exemption under Sections 11-13, subject to applying income for charitable purposes and maintaining accounts.
- Political parties registered under the Representation of the People Act, 1951 are exempt under Section 13A, subject to strict compliance and audit requirements.
- Educational institutions and hospitals are exempt under Section 10(23C), subject to registration/approval and application of income for the stated purpose.

2.11 Further Reading

- Singhania, V.K. & Singhania, M. — Students' Guide to Income Tax (Taxmann Publications) — Latest Edition — Chapter on Exempted Incomes.
- Ahuja, G.K. & Gupta, R. — Systematic Approach to Income Tax (Bharat Law House) — Latest Edition.
- Pagare, Dinkar — Law and Practice of Income Tax (Sultan Chand & Sons) — Latest Edition.
- CBDT Circular No. 23/2017 on Leave Encashment and other departmental circulars — available at www.incometaxindia.gov.in.
- Section 10 of the Income Tax Act, 1961 — Bare Act.

- Finance Act amendments — available at www.indiabudget.gov.in.

2.12 Answers to Check Your Progress

Check Your Progress — I

1. (a) False — A partner's share in firm profits is fully exempt under Section 10(2A).

   (b) False — Uncommuted (periodic) pension is fully taxable as salary income.

   (c) False — HRA exemption is available only if the employee is paying rent for a house NOT owned by them.

   (d) True — Scholarships under Section 10(16) are fully exempt with no upper limit.

2. a. Agricultural Income [Section 10(1)]

   b. Receipts by a Member from a Hindu Undivided Family (HUF) [Section 10(2)]
   c. Share of Profit from a Partnership Firm [Section 10(2A)]

Check Your Progress — II

3. Conditions under Section 13A:
   (i) Party registered under Section 29A of the Representation of the People Act.
   (ii) Books of accounts maintained.
   (iii) Record of donations of Rs. 20,000 or more maintained with donor name and address.
   (iv) Accounts audited by a Chartered Accountant.
   (v) Report submitted to Election Commission.
   (vi) Income tax return filed within due date.
   (vii) Cash donations above Rs. 2,000 per donor not accepted.

4. An anonymous donation is a donation where the donor's identity and address are not maintained by the charitable institution. Under Section 115BBC, anonymous donations exceeding 5% of total donations or Rs. 1 lakh (whichever is higher) are taxable at 30% (plus surcharge and cess). Religious trusts are exempt from this provision.

2.13 Model Questions

Short Answer Questions

1. State any five incomes that are fully exempt from tax under Section 10.
2. What is HRA? How is the exempt portion of HRA calculated?
3. Distinguish between taxable and exempt perquisites with two examples each.
4. Name any three incomes that are partially exempt from tax.

Long Answer Questions

5. Explain in detail the concept of exempted income under Section 10 of the Income Tax Act. Distinguish between fully exempted and partially exempted incomes with suitable examples.
6. Discuss the tax treatment of the following in the hands of an employee: (a) Gratuity, (b) Commuted Pension, (c) Leave Encashment, (d) VRS Compensation.
7. Explain the exemptions available to charitable trusts and institutions under Sections 11, 12, and 12AB. What are the conditions for claiming such exemption?
8. Write a detailed note on the tax exemption available to political parties under Section 13A. What happens if the conditions are not complied with?

UNIT 3 : TAX PLANNING

UNIT STRUCTURE

3.1 Learning Objectives

3.2 Introduction

3.3 Tax Planning for setting up of a new business-

- 3.3.1 Nature
- 3.3.2 Location
- 3.3.3 Form of Business Firm

3.4 Tax Planning for Existing Business

3.5 Tax Planning for Salaried Individuals in Practical Context

3.6 Tax Management

- 3.6.1 Filing of Tax Return
- 3.6.2 Tax Deduction at Source
- 3.6.3 Advance Payment of Tax

3.7 Let Us Sum Up

3.8 Further Reading

3.9 Answers To Check Your Progress

3.10 Model Questions

3.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Understand the key tax considerations involved in setting up a new business — including choice of nature, location, and form of organisation.
- Identify and apply tax planning strategies relevant to existing businesses.
- Distinguish clearly between tax planning, tax avoidance, and tax evasion.
- Understand the meaning and concept of tax management.

3.2 INTRODUCTION

As a tax payer, an assessee always looks for various ways to reduce their tax liability. In the process, they often tend to non-disclosure of income or evade the taxes, which is illegal. However, reducing a tax liability is not always an illegal exercise and can be done through proper tax planning. Tax planning is legal. However, application of tax planning to reduce our taxes requires a thorough understanding of the principles, practices and procedures of tax laws and the ability to apply such knowledge to various practical situations. In this chapter, we shall discuss about tax planning w.r.t. setting up of a new business and w.r.t. financial management decisions to ensure that the incidence of tax is reduced to the extent possible, by taking advantage of the various allowances, deductions and other tax concessions provided under the Income Tax Law.

3.3 TAX PLANNING FOR SETTING UP OF A NEW BUSINESS

We have already covered the meaning and concept of tax planning in our previous units and in this section we shall discuss about the Tax Planning that could be done in case of setting up of new businesses. Due to the new industrial policy, new licensing policy, Export Import (EXIM) policy and Foreign Trade Policy (FTP) along with the monetary and fiscal measures of the government, new businesses are increasingly coming across various sectors and regions. The advent and access to emerging new technologies and new market potential has also attracted new entrepreneurs to invest in various sectors. However, for starting up new businesses one is more concerned about their cost structure, likely profitability in future and sustainability which is influenced to a great extent by their tax liabilities. Since the income of new businesses is mainly chargeable to tax under the head, Business and Profession, Capital Gains and Income from other sources, the new entrepreneur or management takes into account allowable business expenditures in computing taxable business income, the exemptions, deductions, the special incentives available for

particular locations, nature and organisational forms of business to minimise the overall tax liability. The entrepreneur has to find and undertake tax planning in areas where tax liability can be reduced and maximum advantage of the various allowances, deductions and other tax concessions given under the law could be availed.

For a new business, the areas where tax planning is more relevant are as follows:

a) Nature of the Business
b) Location of the Business
c) Form of the Business Firm

3.3.1 Nature of the Business: One of the major consideration in tax planning about new business is the choice of the nature of the business which calls for appropriate planning with reference to the various special benefits available under the taxation laws to the particular kinds of industries which are not available to other kinds. Some of these benefits are of such a substantial nature that they constitute one of the major factors in the determination of the nature of the business. Broadly, business for this purpose may be divided into two categories—trading and manufacturing business. There could be a third category involving combination of both. Deduction is available under section 10AA to newly established units in Special Economic Zones. A taxpayer carrying on manufacturing or industrial activities would be in a position to avail of the various concessions such as Depreciation allowance u/s 32, Spectrum expenditure u/s 35ABA, Telecom licence u/s 35ABB, Preliminary expenses u/s 35D and Mining expenditure u/s 35E. Tax holiday benefit under section 80-IAC would be available in case of eligible start-up, under section 80- IBA in case of developing and building housing projects and under section 80LA in case of offshore banking unit and IFSC located in Special Economic Zone. While deciding the nature of the business, the benefit of tax exemption or treatment available in respect of certain types of income such as agricultural concessional income, new industrial undertakings, ships, business of repairs to ocean going vessels, business of exploration, etc. of mineral oils, etc. should also be taken into account.

3.3.2 Location of the Business: Considering the availability of tax concessions, tax incentives, deductions or allowances on the basis of location of new businesses, tax planning w.r.t. the same is worth exercisable.

The following are the some of the important incentives, concessions, deductions or allowances on the basis of location of businesses:

1. Full exemption under Section 10A for ten years in the case of a newly established industrial undertaking in free trade zones, etc. [Not allowed w.e.f. A.Y. 2012-13].
2. Full exemption under Section 10AA for initial five years, 50% for subsequent five years and further deduction of 50% for a further period of five years in the case of a newly established units in special economic zones on or after 1.4.2005.
3. Full exemption under Section 10B for 10 years in the case of a newly established 100% export-oriented undertaking. [Not allowed w.e.f. 2012-13].
4. Deduction under Section 80-IAB in respect of profits and gains by an undertaking or an enterprise engaged in the development of Special Economic Zone.
5. Deduction under Section 80-IB in the case of newly set up industrial undertaking in an industrially backward State or district.
6. Deduction under Section 80-IC in case of newly set up industrial undertaking or substantial expansion of an existing undertaking in certain special category States. 7. Deduction under Section 80-ID in respect of profits and gains from business of hotels and convention centres in specified area or a hotel at world heritage site.
8. Deduction under Section 80-IE in respect of certain undertakings in North-Eastern States.

3.3.3 Form of the Business Organisation: The choice of the appropriate form of business organisation will have to be thought of and decided by the person who intends to carry on business or profession at the beginning itself, because a change in the form of business organisation after the commencement of the business, may attract liability to tax. A new business can be organised under any of the following forms:

(i) Sole proprietorship
(ii) Hindu undivided family
(iii) Association of persons or Body of Individuals
(iv) Partnership firm/LLP
(v) Company
(vi) Co-operative society

The selection of a particular form of organisation would depend

not only on the tax aspect but on other considerations also, e.g., financial requirements and resources, requirement of limited liability and many other practical considerations.

However, depending upon the taxable status and level of tax liability of the owners, a selection can be made from the various forms available for setting up a new unit.

(i) Sole Proprietorship: In the case of a sole proprietorship concern, remuneration paid to proprietor is not allowed as deduction from business profits of the sole proprietorship firm. Whereas remuneration paid by partnership firm/LLP to its working partner is allowed as deduction subject to sec 40(b) As a result, the taxable income from business would get reduced and correspondingly, the incidence of tax would also be reduced.Under sole proprietorship, the entire income of a business unit gets assessed in the hands of the same person along with other income, while the entire loss and other allowances shall be available for set off in his hands against other income. This may have some advantage in the initial years, after which the possibility of converting it into company/firm may be considered; on such conversion, the questions of possible capital gains tax, etc., will have to be considered.

(ii) Hindu Undivided Family 'HUF': The HUF is treated as a separate entity under the Income Tax Act. Since the law does not specifically provide for the disallowance of such expenses, it is advantageous to carry on a business through the HUF wherever possible. The income of the family is computed and first taxed in the hands of the family at the rates applicable to it. The income of the family may, thereafter, be divided amongst the members of the family and the members, in such cases, do not attract any liability to tax in view of the specific exemption granted under section 10(2) of the Income-tax Act, 1961. Thus, if a business is carried on by a Hindu undivided family, the advantages which are available in the case of a company could be fully availed of and in addition, the members of the family would not become liable to tax when they receive any portion of the family's income.

(iii) Partnership and LLP: All firms and LLPs will be taxed at a flat rate of 30%. If the total income exceeds 1 crore, surcharge @ 12% is applicable. There will be no initial exemption and the entire income will be taxed. In computing the taxable income of a firm, certain prescribed deductions in respect of interest and remuneration have to be allowed. The share income of a firm in the hands of the partners of the firm is fully exempt under section 10(2A). Also, partnership firms carrying on eligible business can declare income on presumptive basis as per the provisions of section 44AD@8% of gross receipts (6% in case gross receipts are received by an account payee cheque/bank draft/ use of ECS through bank account). Partnership firms carrying on notified profession can declare income on presumptive basis@50% of gross receipts as per the provisions of section 44ADA.

(iv) Company: Within the company form of organisation, however, several alternatives exist. On the basis of the ownership and control, a company can either be organised as a widely held company, i.e. a company in which the public are substantially interested u/s 2(18) of the Income-tax Act, 1961. Alternatively, it can be organised as a closely held company. Depending upon the choice of the form of organisation of the company, the following important tax consequences would have to be considered from the view point of tax planning:

(1) The General tax rate of domestic company is 30% and if turnover is upto '250 crores in F/Y 16/17 then General tax rate is 25%.

(2) The general tax rate of foreign company is 40%.

(3) The surcharge on domestic company is 7% if Total Income exceeds 1 crore and 12% if Total Income exceeds 10 crores.
(4) The surcharge on foreign company is 2% if Total Income exceeds 1 crore and 5% if Total Income exceeds 10 crores.
(5) The provisions of section 79 regarding restrictions on carry forward of losses in the event of substantial change in the shareholding of the company also become applicable if the company is one in which the public are not substantially interested. This aspect would assume particular significance in the case of closely held companies where losses are made and shareholdings are transferred before such losses are fully absorbed.
(6) Domestic companies have to pay CDT @ 15% plus surcharge @12% plus cess @ 4% on dividend declared, distributed or paid u/s 115O.

(7) MAT provisions are applicable to companies. It so happens that in case of companies enjoying tax holiday benefits still have to pay tax under MAT provisions, credit of which also cumulated for number of years without being used causing significant outflow of funds in the initial years.

3.4 TAX PLANNING FOR EXISTING BUSINESS

For businesses already in operation, tax planning is a continuous process that spans the entire financial year. Unlike new businesses where structural decisions dominate, existing businesses focus on maximising deductions, timing transactions strategically, and ensuring compliance. Key strategies include:

i) Maximising Depreciation Deductions [Section 32]

Depreciation is a powerful tool in an existing business's tax planning arsenal. Key considerations:

- Additional Depreciation: New manufacturing plants and machinery (not second-hand) are eligible for an additional 20% depreciation in the year of acquisition. For units in specified backward areas, this is 35%.
- Block of Assets: Assets are grouped into 'blocks' for depreciation — ensuring that additions and disposals are timed to maximise the depreciation claim.
- Timing of Asset Purchase: Purchasing an asset before 31st March (even if put to use just before year-end) allows a full or half year's depreciation depending on when it was put to use — purchase after 31st March means the first depreciation is in the next AY.

ii) Claiming All Admissible Business Expenditure [Sections 30–37]

All expenditure 'wholly and exclusively' incurred for the purpose of business is deductible. Many businesses miss claiming legitimate deductions:

- Rent, repairs, and insurance on business premises [Section 30].

- Repairs and insurance on plant, machinery, and furniture [Section 31].
- Expenditure on scientific research [Section 35].
- Revenue expenditure on skill development of employees [Section 35CCD] — weighted deduction of 150%.
- Bad debts actually written off [Section 36(1)(vii)].
- Employer's contribution to approved funds (PF, Gratuity Fund, Superannuation Fund) [Section 36(1)(iv) and (v)].
- Any other expenditure not specifically disallowed — the residual category [Section 37(1)].

iii) Strategic Use of Set-Off and Carry Forward of Losses [Sections 70–80]

Business losses can be powerful tax planning tools:

- Intra-head set-off: A loss from one business can be set off against profit from another business in the same year.
- Inter-head set-off: A business loss (other than speculative loss) can be set off against income under other heads (e.g., salary, house property) in the same year.
- Carry forward: Unabsorbed business losses can be carried forward for 8 assessment years and set off against business income of future years. Unabsorbed depreciation can be carried forward indefinitely.
- Tax planning implication: Timing the realisation of income and losses across years can systematically reduce tax liability.

iv) Investment in Eligible Bonds and Instruments [Section 54EC, 80C, etc.]

Long-term capital gains from sale of property or other assets can be reinvested in:

- Section 54EC Bonds (NHAI/REC bonds) within 6 months of sale — exempts capital gains up to Rs. 50 lakh.
- New residential property under Sections 54 and 54F.
- Capital Gains Account Scheme (CGAS) — for parking gains temporarily before reinvestment.

v) Salary Structuring for Owner-Managers

In a private limited company, the owner-manager can draw a salary (deductible from company income) rather than taking dividends (which are taxable in the hands of the recipient and not deductible by the company). Optimal salary structuring — including appropriate allowances and perquisites — reduces the overall tax outflow of the business and its promoters.

vi) Tax Planning Through Donations [Section 80G]

Contributions to approved charitable institutions offer the business a deduction of 50% or 100% of the donation amount. Strategic philanthropy — donating to approved causes — simultaneously fulfils corporate social responsibility objectives and reduces taxable income.

CHECK YOUR PROGRESS

1. State any two important tax incentive allowed to tax payers on the basis of location of businesses.

2. State any two key strategies with respect to tax planning for existing business.

3.5 TAX PLANNING FOR SALARIED INDIVIDUALS IN PRACTICAL CONTEXT

Salaried individuals form the largest category of income tax filers in India. While their income is largely fixed and less flexible than business income, there are still substantial tax planning opportunities available — particularly through optimal salary structuring, investment in tax-saving instruments, and claiming all available deductions. A salaried individual can follow the below mentioned steps for efficient tax planning.

i) Choose the Tax Regime wherein Tax burden is minimum.

Since AY 2021-22, taxpayers can choose between the Old Tax Regime (with deductions and exemptions) and the New Tax Regime (lower slab rates, but most deductions and exemptions unavailable). The Finance Act, 2023 made the New Regime the default, but taxpayers can opt for the Old Regime.

Income Slab	Old Regime Rate	New Regime Rate (AY 2024-25)
Up to Rs. 3,00,000	Nil	Nil
Rs. 3,00,001 – Rs. 6,00,000	5% (after basic exemption of Rs. 2.5L)	5%
Rs. 6,00,001 – Rs. 9,00,000	20%	10%
Rs. 9,00,001 – Rs. 12,00,000	20%	15%
Rs. 12,00,001 – Rs. 15,00,000	30%	20%
Above Rs. 15,00,000	30%	30%

The Old Regime is generally beneficial if total deductions and exemptions exceed approximately Rs. 3.75 lakh (the break-even point varies by income). The New Regime is more beneficial for those with fewer investments or who cannot claim major deductions.

ii) Optimise Salary Structure

Working with the employer's HR/payroll team to restructure CTC (Cost to Company) can yield significant tax savings without reducing take-home pay:

- Maximise HRA component if renting accommodation.
- Include Leave Travel Allowance (LTA) in the CTC for domestic travel exemption.
- Include food coupons/meal allowances (up to Rs. 50 per meal — exempt as a perquisite).
- Opt for reimbursement of telephone, broadband, and fuel/vehicle expenses instead of cash allowances.
- Request employer to contribute to NPS on employee's behalf — employer's NPS contribution up to 10% of (basic + DA) is deductible under Section 80CCD(2), available even under the New Regime.

iii) Maximise Deductions under Chapter VI-A (Old Regime)

The following deductions are available under the Old Tax Regime:

Section	Nature of Deduction	Maximum Limit
80C	PPF, ELSS, Life Insurance Premium, NSC, 5-year FD, Home Loan Principal, Children's Tuition Fees, EPF	Rs. 1,50,000
80CCD(1B)	Additional NPS contribution by employee (over and above 80C limit)	Rs. 50,000 (additional)
80CCD(2)	Employer's contribution to NPS on behalf of employee	10% of (Basic + DA) — no monetary ceiling; available under New Regime too
80D	Health insurance premiums for self, family, and parents	Self + family: Rs. 25,000 (Rs. 50,000 if senior citizen). Parents: additional Rs. 25,000 (Rs. 50,000 if senior)
80E	Interest on education loan for higher	Full interest — no ceiling;

	education	available for 8 years
80EEA	Interest on home loan for first-time buyers (affordable housing, stamp duty value ≤ Rs. 45 lakh)	Rs. 1,50,000 (over and above Section 24(b))
80G	Donations to approved charitable institutions, PM Funds, etc.	50% or 100% of donation amount; subject to conditions
80TTA / 80TTB	Interest on savings account deposits (80TTA) / all deposits for senior citizens (80TTB)	Rs. 10,000 (80TTA); Rs. 50,000 (80TTB for seniors)
24(b)	Interest on home loan for self-occupied property (head: Income from House Property)	Rs. 2,00,000 per year

iv) Time Your Investments

Tax planning is a year-round activity, not a last-minute March rush:

- Start SIPs (Systematic Investment Plans) in ELSS at the beginning of the financial year — you build the corpus faster and avoid last-minute fund selection pressure.
- Pay health insurance premiums at the beginning of the year to ensure no lapse in coverage and an immediate deduction.
- If planning to sell equity shares or mutual funds, be mindful of the holding period — short-term vs. long-term capital gains attract different tax rates.

Claim losses before the end of the financial year — realise loss-making investments to set off against gains.

3.6 TAX MANAGEMENT

Tax management refers to the operational aspect of tax compliance — ensuring that all tax obligations are met accurately, completely, and on time. While tax planning is about minimising tax, tax management is about correctly discharging the tax that is legitimately due. Poor tax management can unravel the most sophisticated tax plan through avoidable penalties and interest.

Tax management encompasses three core activities: filing the income tax return, deducting and remitting TDS, and paying advance tax.

3.6.1 FILING OF TAX RETURN

The income tax return (ITR) is a formal declaration of income, deductions, and tax paid for a financial year, filed with the Income Tax Department. It is the cornerstone of the tax compliance system. Filing of return is mandatory for:

- Every company and firm (regardless of whether there is income or loss).
- Any individual, HUF, AOP, or BOI whose total income (before deductions under Chapter VI-A) exceeds the basic exemption limit (Rs. 2.5 lakh for individuals below 60 years; Rs. 3 lakh for senior citizens; Rs. 5 lakh for super senior citizens above 80 years — under Old Regime).
- Any individual who has deposited more than Rs. 1 crore in bank accounts, incurred expenditure of more than Rs. 2 lakh on foreign travel, or incurred electricity consumption of Rs. 1 lakh or more — even if income is below the exemption limit.
- Any person with income from a foreign asset, or a signing authority in a foreign account.
- Any person claiming a refund of taxes deducted at source.

i) **Selection of appropriate tax return:** In order to file tax return, a tax payer has to choose an appropriate form issued by the Income Tax Department each designed for specific categories of taxpayers and types of income.

Form	**Applicable To**
ITR-1 (Sahaj)	Resident individuals with income from salary/pension, one house property, and other sources (interest etc.) — total income up to Rs. 50 lakh.
ITR-2	Individuals/HUFs with income from salary, more than one house property, capital gains, or foreign income — but NOT having business/profession income.
ITR-3	Individuals/HUFs with income from business or profession (including partners in firms).
ITR-4 (Sugam)	Individuals, HUFs, and firms (not LLPs) opting for presumptive taxation under Sections 44AD, 44ADA, or 44AE.
ITR-5	Firms, LLPs, AOPs, BOIs, and other entities (other than companies and trusts filing ITR-7).
ITR-6	Companies other than companies claiming exemption under Section 11.
ITR-7	Persons including companies required to furnish return under Sections 139(4A), 139(4B), 139(4C), or 139(4D) — trusts, political parties, research associations, etc.

ii) **Due Dates for Filing Returns:** Assessee should file their tax returns on or before the due dates to avoid interest or any penal provisions under the income tax laws. Further, filing the

tax returns after due date limits and restricts carrying forward of business and capital lossess.

Category of Taxpayer	Due Date
Individuals, HUFs, BOIs, AOPs (accounts not required to be audited)	31st July of the Assessment Year
Businesses/Professionals whose accounts are required to be audited	31st October of the Assessment Year
Companies	31st October of the Assessment Year
Persons required to furnish transfer pricing report (international/specified domestic transactions)	30th November of the Assessment Year
Belated Return [Section 139(4)]	31st December of the Assessment Year (with interest u/s 234A and late fee u/s 234F)
Updated Return [Section 139(8A)]	Within 2 years from the end of the relevant AY (with additional tax of 25%/50%)

iii) **Consequences of Not Filing Return**

- Interest under Section 234A: 1% per month on unpaid tax from the due date to the date of actual filing.
- Late Fee under Section 234F: Rs. 5,000 if filed after due date but before 31st December; Rs. 10,000 if filed after 31st December (reduced to Rs. 1,000 if total income is below Rs. 5 lakh).
- Losses (other than house property loss) cannot be carried forward if the return is filed after the due date.
- Prosecution under Section 276CC for wilful failure to file return.

3.6.2 TAX DEDUCTION AT SOURCE

Tax Deduction at Source (TDS) is a mechanism whereby the payer of income (the deductor) deducts tax at the prescribed rate before making payment to the payee (the deductee) and remits it to the government on the payee's behalf. It is the government's method of collecting tax at the point of income generation, ensuring early receipt of revenue and reducing the scope for evasion.

i) Important TDS Provisions

Sec.	Nature of Payment	Threshold	TDS Rate	Who Deducts

			(Resident)	
192	Salary	Above basic exemption limit	At applicable slab rates	Employer
193	Interest on Securities	Rs. 5,000 (debentures); Rs. 10,000 (others)	10%	Company/issuer
194A	Interest (other than on securities — e.g., bank FD interest)	Rs. 40,000 (Rs. 50,000 for senior citizens)	10%	Bank / Payer
194C	Payment to Contractors / Sub-contractors	Rs. 30,000 per contract; Rs. 1,00,000 aggregate in FY	1% (individual/HUF); 2% (others)	Specified persons
194H	Commission or Brokerage	Rs. 15,000	5%	Any person (not individual/HUF below audit threshold)
194I	Rent (land, building, furniture, fittings)	Rs. 2,40,000 per annum	10% (land/building); 2% (machinery)	Any person (not individual/HUF below audit threshold)
194J	Professional / Technical Services Fees	Rs. 30,000	10% (professional); 2% (technical services)	Any person (not individual/HUF below audit threshold)
194IA	Purchase of Immovable Property	Sale consideration ≥ Rs. 50 lakh	1%	Buyer of property
195	Payments to Non-Residents	Any amount chargeable to tax	Rates in force / DTAA rates	Any person making payment to NR

ii) TDS Compliance Obligations

- Obtain a Tax Deduction and Collection Account Number (TAN) before deducting TDS.
- Deduct TDS at the prescribed rate at the time of payment or credit, whichever is earlier.
- Deposit TDS with the government by the 7th of the following month (by 30th April for March deductions).
- File quarterly TDS returns: Form 24Q (salary), Form 26Q (other payments to residents), Form 27Q (payments to non-residents).
- Issue TDS certificates: Form 16 (salary) by 15th June; Form 16A (others) within 15 days of the due date of TDS return.

iii) Consequences on Non-Compliance: Failure to deduct TDS or failure to deposit it after deduction attracts:

(a) Disallowance of 30% of the related expenditure [Section 40(a)],

(b) Interest at 1.5% per month on the undeducted/undeposited TDS [Section 201(1A)],

(c) Penalty of Rs. 10,000 to Rs. 1,00,000 for failure to file TDS return [Section 271H].

3.6.3 ADVANCE PAYMENT OF TAX

Advance tax is the payment of income tax in installments during the financial year itself, before the end of the year. It operates on the principle of 'pay as you earn' — rather than settling the entire tax liability at the end of the year in a lump sum. Advance tax is mandatory for taxpayers whose estimated tax liability for the year exceeds Rs. 10,000 (after credit of TDS).

i) Assessees Liable for Advance Tax

- All taxpayers (individuals, HUFs, firms, companies) whose net tax liability (after TDS) exceeds Rs. 10,000 in a year.
- Senior citizens (aged 60 years or above) who are NOT running a business or profession are EXEMPT from advance tax.
- Taxpayers opting for presumptive taxation under Section 44AD can pay their entire advance tax in one instalment by 15th March.

ii) Advance Tax Instalment Schedule

Due Date	Instalment (Non-corporate)	Instalment (Corporate)
On or before 15th June	15% of estimated tax liability	15% of estimated tax liability
On or before 15th September	45% of estimated tax liability (cumulative)	45% of estimated tax liability (cumulative)
On or before 15th December	75% of estimated tax liability (cumulative)	75% of estimated tax liability (cumulative)

On or before 15th March	100% of estimated tax liability (cumulative)	100% of estimated tax liability (cumulative)

iii) Interest for Default in Advance Tax [Sections 234B and 234C]

If advance tax is not paid or is underpaid, interest is levied as follows:

- Section 234B: If total advance tax paid is less than 90% of assessed tax — interest at 1% per month from 1st April of the Assessment Year to the date of actual payment.
- Section 234C: If any instalment is less than the prescribed percentage — interest at 1% per month for 3 months (for June, September, December instalments) and for 1 month (for March instalment).

CHECK YOUR PROGRESS

3. State any two important deductions allowed to an individual assessee under Chapter VI A of the Income Tax Act.
4. What do you mean by Advance Payment of Tax.

3.7 LET US SUM UP

This unit has covered the principles and practice of tax planning. In this unit we have discussed the following:

- Tax planning is the legal and proactive arrangement of financial affairs to minimise tax liability using provisions explicitly available in the Income Tax Act. It is encouraged by courts and the government alike.
- Four types of tax planning exist: Short-range, Long-range, Permissive, and Purposive — each suited to different situations and time horizons.
- Setting up a new business involves three key tax planning decisions: the nature of business (choosing tax-incentivised industries), the location (SEZ, North-East, backward areas), and the form of organisation (sole proprietorship, partnership, LLP, company).
- For existing businesses, tax planning focuses on maximising depreciation, claiming all admissible expenses, using loss carry-forward provisions, and structuring compensation efficiently.
- Salaried individuals can plan taxes through optimal salary structuring, choosing the right tax regime (Old vs. New), and maximising deductions under Sections 80C, 80CCD(1B), 80D, 24(b), and others.

- Tax management comprises three pillars: (a) Filing ITR on time in the correct form, (b) TDS deduction, deposit, and reporting compliance, and (c) Advance tax payment in four instalments by prescribed due dates.
- Failure to comply with TDS or advance tax obligations attracts interest under Sections 234A/B/C and penalties — making tax management as important as tax planning.

3.8 FURTHER READING

- Singhania, V.K. — Taxmann's Direct Taxes: Law & Practice (Taxmann Publications) — Latest Edition
- Ahuja, G.K. & Gupta, R. — Corporate Tax Planning and Management (Bharat Law House) — Latest Edition
- Kanga, Palkhivala, Vyas — The Law and Practice of Income Tax (LexisNexis) — Latest Edition
- CBDT Circular on GAAR: Circular No. 7/2017 dated 27th January 2017
- Ministry of Finance — FAQs on New Tax Regime: www.incometaxindia.gov.in
- Income Tax e-Filing Portal (ITR filing, TDS returns, advance tax payment): www.incometax.gov.in
- TRACES Portal (TDS certificates and reconciliation): www.tdscpc.gov.in

3.9 ANSWERS TO CHECK YOUR PROGRESS

1. (i) Deduction under Section 80-IAB in respect of profits and gains by an undertaking or an enterprise engaged in the development of Special Economic Zone.

(ii) Deduction under Section 80-IB in the case of newly set up industrial undertaking in an industrially backward State or district.

2. i) Maximising depreciation deductions [Section 32]

ii) Claiming all admissible business expenditure [Sections 30–37]

3.

Section	Nature of Deduction	Maximum Limit
80C	PPF, ELSS, Life Insurance Premium, NSC, 5-year FD, Home Loan Principal, Children's Tuition Fees, EPF	Rs. 1,50,000
80D	Health insurance premiums for self, family, and parents	Self + family: Rs. 25,000 (Rs. 50,000 if senior citizen). Parents: additional Rs. 25,000 (Rs. 50,000

		if senior)

4. Advance tax is the payment of income tax in installments during the financial year itself, before the end of the year. It operates on the principle of 'pay as you earn' — rather than settling the entire tax liability at the end of the year in a lump sum. Advance tax is mandatory for taxpayers whose estimated tax liability for the year exceeds Rs. 10,000 (after credit of TDS).

3.10 MODEL QUESTIONS

Short Answer Questions

1. Define tax planning. What are its main objectives?
2. What are the consequences of failure to pay advance tax?
3. Name the different ITR forms and the category of taxpayers to whom each applies.

Long Answer Questions

1. Write a detailed note on tax planning considerations while setting up a new business, covering the nature of business, choice of location, and form of organisation.
2. Explain the system of advance tax payment in India. Who is liable to pay advance tax? What are the instalments and due dates? What are the consequences of default?
3. Write a comprehensive note on Tax Deduction at Source (TDS) — its purpose, key provisions, compliance obligations for deductors, and consequences of non-compliance.

Practical / Numerical Questions

1. ABC Pvt. Ltd. makes the following payments in FY 2025-26: (a) Rent for office premises: Rs. 6,00,000 p.a. to Mr. Ramesh. (b) Professional fees to CA Priya: Rs. 1,80,000. (c) Contract payments to M/s XYZ: Rs. 5,00,000 in aggregate. Compute the TDS to be deducted, the section under which it falls, and the applicable rate for each.
2. Ms. Divya has a salary of Rs. 10 lakh per year. She can invest up to Rs. 2 lakh additionally in tax-saving instruments. Compare her tax liability under the Old Regime (with full deductions of Rs. 3.5 lakh including 80C, 80D, and HRA) vs. the New Regime (standard deduction of Rs. 50,000 only). Which regime is better for her?

UNIT 4 : HEADS OF INCOME – INCOME FROM SALARIES

UNIT STRUCTURE

4.1 Learning Objectives

4.2 Introduction

4.3 Heads of Income

4.4 Salaries: Meaning and Features

4.5 Allowances

4.6 Perquisites and Tax Treatment

4.7 Profits in Lieu of Salary

4.8 Retirement Benefits

- 4.8.1 Gratuity
- 4.8.2 Pension
- 4.8.3 Leave Encashment
- 4.8.4 Provident Fund

4.9 Deductions from Salary

4.10 Computation of Taxable Salary

4.11 Let Us Sum Up

4.12 Further Reading

4.13 Answers To Check Your Progress

4.14 Model Questions

4.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Understand the five heads of income under the Income Tax Act.

- comprehend the meaning of salary, profits in lieu of salary, allowances, perquisite and various retirement benefits.
- Identify the taxable and exempt components of various allowances received by employees.
- Understand 'profits in lieu of salary' and their tax treatment under Section 17(3).
- Explain the taxable and exempt portions of retirement benefits — gratuity, pension, leave encashment, and provident fund.
- compute the income chargeable to tax under the head “Salaries”.

4.2 INTRODUCTION

In this Unit we shall discuss about the heads of income as per Income Tax Act and also discuss in details about one of the heads of Income i.e. Income from Salaries.

A person may earn income from various sources viz. salary, business, profession, etc. ‘Income’ of a person for the purpose of charging of income taxand computation of total income, has been classified into five mutually exclusive heads.This classification of income into various heads is very important for income tax purposes. It is important to note here that an item of income will be liableto tax only if it can be classified under one of these heads of income as prescribed under the Income Tax Act. The Income Tax Act specifies the manner of computation of income separately in respect of each head of income, and those provisions will have to be applied for computing the income under each heads of income. Further, we shall also have a detailed study of “Income from Salaries” covering topics relating to profits in lieu of salary, allowances, perquisite and various retirement benefits;

4.3 HEADS OF INCOME

According to Sec.14 of the Income Tax Act, incomes earned by a person from various sources shall be classified under the following five heads:

1. Salaries;
2. Income from house property;
3. Profits and gains from business or profession;
4. Capital gains;
5. Income from other sources.

For computation of income, all taxable income should fall under any of the five heads of income as mentioned above. If any type of income does not become part of any one of the above mentioned first four heads, it should be part of the fifth head, i.e. Income from other sources, which may be termed as the residual head. Further, income chargeable under a particular head cannot be charged under any other head.

4.4 SALARIES: MEANING AND FEATURES

Income from salaries is described in Sections 15 to 17 of the Income Tax Act. The meaning of the term 'salary' for purposes of Income tax is much wider than what is normally understood. Every payment made by an employer to his employee for service rendered would be chargeable to tax as income from salaries. The term 'salary' for the purposes of Income Tax Act will include both monetary payments (e.g. basic salary, bonus, commission, allowances etc.) as well as non-monetary facilities (e.g. housing accommodation, medical facility, interest free loans etc).

Section 17(1) provides an inclusive definition of 'salary'. The term 'salary' for income tax purposes is much broader than the colloquial meaning of a monthly pay cheque. It includes:

- Wages — periodic payments for manual or skilled labour.
- Any annuity or pension.
- Any gratuity.
- Any fees, commission, perquisites, or profits in lieu of, or in addition to, salary or wages.
- Any advance of salary — amounts paid in advance of the period for which they are earned.
- Any payment received in respect of any period of leave not availed of (leave encashment).
- The annual accretion to the credit of an employee in a recognised provident fund, in excess of specified limits.
- The aggregate of transferred balances in a recognised provident fund, in certain circumstances.
- The contribution made by the Central Government or any other employer to the account of an employee under a pension scheme referred to in Section 80CCD.

Before learning the provisions, it is essential to understand the important concepts relating to Salaries.

(1) **Employer-employee relationship:** Before an income can become chargeable under the head 'salaries', it is vital that there should exist between the payer and the payee, the relationship of an employer and an employee.

(2) **Full-time or Part time employment:** It does not matter whether the employee is a fulltime employee or a part-time one. Once the

relationship of employer and employee exists, the income is to be charged under the head “Salaries”. If, for example, an employee works with more than one employer, salaries received from all the employers should be clubbed and brought to charge for the relevant Previous Years.

(3) **Foregoing or sacrificing of salary:** Once salary accrues, the subsequent waiver by the employee does not absolve him from liability to Income- tax. Such waiver is only an application and hence, chargeable to tax.

(4) **Surrender of salary:** However, if an employee surrenders his salary to the Central Government u/s 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered would be exempt while computing his taxable income.

(5) **Salary paid tax-free:** This, in other words, means that the employer bears the burden of the tax on the salary of the employee. In such a case, the income from salaries in the hands of the employee will consist of his salary income and also the tax on this salary paid by the employer. This means both the salary and the tax paid thereon will be taxable in the hands of the employee.

(6) **Voluntary Payments:** Whether the payment from an employer is based on a contract or not, it constitutes salary in the hands of the employee. However, many employers give personal gifts and testimonials to the employees. For example, employees who complete 20 years of service may be given a wrist watch. The question arises whether the value of the watch can be taxed in the hands of the employee. Courts have taken the view that such gifts are not taxable. However, in these cases it is important that such gifts must be given to employees pursuant to a scheme applicable to employees in general. If gifts are given purely on a selective basis they will become chargeable in the hands of the recipient.

(7) **Place of accrual of Salary:** According to section 9(1)(ii), salary earned in India is deemed to accrue or arise in India even if it is paid outside India or it is paid or payable after the contract of employment in India comes to an end.

If an employee is paid pension abroad in respect of services rendered in India, the same will be deemed to accrue in India. Similarly, leave salary paid abroad in respect of leave earned in India is deemed to accrue or arise in India.

The basis of charge of Salary has been defined in Section 15 of Income Tax Act and according to it the following

forms of salary shall be charged to tax under the head ‘‘Income from Salaries’’.

(i) Salary is taxable on due or receipt basis whichever is earlier,

(ii) Salary received in advance,

(iii) Salary from present and former employer and

(iv) Arrears of salary.



CHECK YOUR PROGRESS

Q 1: Mention the various heads of income as per Income Tax Act?

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4.5 ALLOWANCES

Allowances are fixed amounts paid by an employer to an employee over and above the basic salary to help meet specific expenses. Different types of allowances are given to employees by their employers. For income tax purposes, allowances are classified into three categories:

- Fully Taxable Allowances: Included entirely in the employee's salary income.
- Fully Exempt Allowances: Excluded entirely from salary income.
- Partially Exempt Allowances: Exempt up to a prescribed limit; the excess is taxable.

Under the Income Tax Act, 1961, allowance is taxable on due or receipt basis, whichever is earlier. A few common allowances paid to employees are as follows:

- Dearness Allowances
- Entertainment Allowances
- Overtime Allowances
- Fixed Medical Allowances
- House Rent Allowances
- Travelling Allowances

- Allowances to High Court Judges
- City Compensatory Allowances
- Hilly Area Allowances
- Children Education Allowances

In Unit 2, we have already discussed about a few allowances and the incidence of tax liability with respect to the same.

4.6 PERQUISITES AND TAX TREATMENT

The term ‘perquisite’ any benefit or amenity provided by an employer to an employee in addition to the amount that may be legally due by way of contract for services rendered. Section 17(2) defines 'perquisite' inclusively. In modern times, the salary package of an employee normally includes monetary salary and perquisites like housing, car etc.

• Perquisite may be provided in cash or in kind.

• Reimbursement of expenses incurred in the official discharge of duties is not a perquisite.

• Perquisite may arise in the course of employment or in the course of profession. If it arises from a relationship of employer-employee, then the value of the perquisite is taxable as salary. However, if it arises during the course of profession, the value of such perquisite is chargeable as profits and gains of business or profession.

• Perquisite will become taxable only if it has a legal origin. An unauthorized advantage taken by an employee without his employer’s sanction cannot be considered as a perquisite under the Act.

Tax Treatment of Perquisites

For tax purposes, perquisites are classified into three categories:

Category 1	**Perquisites Taxable for ALL Employees**

These perquisites are included in the salary income of every employee, regardless of their income level or category:

Perquisite	**Taxable Value**

Rent-Free Accommodation (Government Employee)	License fee determined by the government.
Rent-Free Accommodation (Non-Government, owned by employer)	15% of salary if population of city > 25 lakh; 10% if 10–25 lakh; 7.5% if < 10 lakh. Less: any rent recovered from employee.
Rent-Free Accommodation (leased/hired by employer)	Lease rent paid by employer OR prescribed percentage of salary, whichever is lower. Less: rent recovered.
Motor Car — Used exclusively for personal purposes	Actual expenditure incurred by employer on running/maintenance + 10% p.a. of original cost (driver's salary if provided). Less: amount recovered from employee.
Motor Car — Used for both official and personal purposes (engine up to 1600cc)	Rs. 1,800/month (+ Rs. 900/month if driver provided). No proof of actual expenditure needed.
Motor Car — Used for both official and personal purposes (engine above 1600cc)	Rs. 2,400/month (+ Rs. 900/month if driver provided).
Interest-free or concessional loan (exceeding Rs. 20,000 in aggregate)	Interest on the outstanding loan balance at the SBI prime lending rate, less interest actually paid.
Gift or voucher exceeding Rs. 5,000 in value	Entire value of gift/voucher (not just the excess over Rs. 5,000) is taxable if total exceeds Rs. 5,000.
Life insurance premium paid by employer on employee's life	Premium amount is taxable as perquisite.
Free meals exceeding Rs. 50 per meal (or meals during working hours but outside office)	Value of meals less Rs. 50 per meal and less any amount recovered from employee.

Club membership fees for personal use	Full amount paid by employer for personal use. Official club use is not taxable.

Category 2	**Perquisites Taxable Only for 'Specified Employees'**

A 'specified employee' means: (a) a director, OR (b) an employee who has a substantial interest (>20% equity) in the employer company, OR (c) an employee whose salary exceeds Rs. 50,000 per year (after excluding non-monetary perquisites).

The following perquisites are taxable only if provided to a specified employee:

- Domestic servants: Cook, sweeper, gardener, watchman — taxable at the cost to the employer less any amount recovered from the employee.
- Gas, electricity, or water supplied free or at a concessional rate for personal use.
- Educational facility for children: Taxable if the per-child annual cost exceeds Rs. 1,000 per month in a school maintained by the employer (excess only is taxable).
- Free or concessional transport for personal journeys by the employer's own means of transport.

Category 3	**Perquisites Exempt from Tax (for All Employees)**

The following perquisites are fully exempt and not included in salary income:

- Medical treatment in a hospital owned or maintained by the employer.
- Reimbursement of medical expenses for treatment in a government hospital.
- Group medical insurance (Mediclaim) premium paid by the employer.
- Refreshments/tea/snacks provided during working hours in office premises.
- Recreational facilities provided uniformly to all employees (gym, sports club on campus, etc.).
- Accommodation provided at a project site in a remote area or on offshore rigs.
- Use of laptop, computer, or tablet provided for official use (personal use incidentally is also exempt).
- Telephone/mobile phone provided by employer — exempt whether used at office or at home.
- Free or subsidised educational facility provided in a school maintained by the employer — up to Rs. 1,000 per month per child.
- Interest-free or concessional loans up to Rs. 20,000 in aggregate.
- Employer's contribution to EPF, NPS, or approved superannuation fund — up to Rs. 7,50,000 in aggregate per year (excess is a taxable perquisite).
- Any travelling/touring/accommodation expenses for official purposes.



CHECK YOUR PROGRESS

Q 2: Mention any five types of allowances paid to employees.

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4.7 PROFITS IN LIEU OF SALARY

Section 17(3) defines 'profits in lieu of salary' — these are payments received by an employee from the employer that are substitutes for or connected to salary, but are not regular salary payments. They are fully taxable as salary income (unless specifically exempt). The following are included:

- The amount of any compensation received by an employee — or his legal heirs — due to the termination of employment or modification of the terms of employment.
- Any payment received from a provident fund or other fund (to the extent it is not exempt under Section 10).
- Any sum received under a Keyman Insurance Policy — whether received as proceeds of the policy or as a bonus on such policy (if it has not been converted into an ordinary life insurance policy before the date of maturity/claim).
- Any amount received by an employee before joining or after leaving employment that, but for this provision, would not be chargeable under 'Salaries' — for example, a joining bonus paid before the employment formally commences, or a golden handshake paid after retirement.

4.8 RETIREMENT BENEFITS

When an employee retires or leaves employment, they typically receive a range of payments — gratuity, pension, leave encashment, and provident fund — that represent the culmination of years of service. Each of these has a specific tax treatment under the Income Tax Act, balancing the legitimate reward for long service with the need to limit tax concessions.

4.8.1 Gratuity

Gratuity is a lump sum payment made by the employer to an employee as a reward for long and meritorious service, payable on retirement, death, disablement, or resignation after a minimum period of service. The tax treatment depends on the category of employee:

Employee Category	Exempt Amount	Formula / Limit
Government Employees (Central, State, Local Authority)	**FULLY EXEMPT — no upper limit**	Entire gratuity received is tax-free.
Non-Government — Covered by Payment of Gratuity Act, 1972	Least of: (a) Actual gratuity received, (b) 15/26 × Last drawn salary × Completed years of service, (c) Rs. 20,00,000	'Salary' = Basic + DA. '15/26' = 15 days for each year (26 working days/month). Part year > 6 months = 1 full year.
Non-Government — NOT covered by Payment of Gratuity Act	Least of: (a) Actual gratuity received, (b) ½ × Average salary × Completed years of service, (c) Rs. 20,00,000	'Average salary' = average of salary of last 10 months preceding retirement. Part year ignored.

Illustration:

Mr. Rajiv retires after 32 years and 8 months of service. Last drawn basic salary: Rs. 65,000/month. DA (part of salary): Rs. 12,000/month. Actual gratuity received: Rs. 18,00,000. Compute taxable gratuity.

Solution:

Salary for gratuity = Rs. 65,000 + Rs. 12,000 = Rs. 77,000/month

Years of service = 32 years + 8 months. Since 8 months > 6 months, count as 33 years.

(a) Actual gratuity = Rs. 18,00,000

(b) 15/26 × Rs. 77,000 × 33 = Rs. 14,63,077

(c) Rs. 20,00,000

Exempt Gratuity = Least of (a), (b), (c) = Rs. 14,63,077

Taxable Gratuity = Rs. 18,00,000 − Rs. 14,63,077 = Rs. 3,36,923

4.8.2 Pension

Pension is a periodic payment made by an ex-employer to a retired employee. It is taxable under the head 'Salaries'. Pension can be of two types:

Type of Pension	Nature	Tax Treatment
Uncommuted (Regular) Pension	Monthly/periodic payments received as pension.	FULLY TAXABLE for all employees — government or non-government. Taxed at slab rates.
Commuted Pension (Lump Sum)	Converting a portion of regular pension entitlement into a lump sum upfront.	Government employees: FULLY EXEMPT. Non-government (with gratuity): 1/3rd of full commuted value exempt. Non-government (without gratuity): 1/2 of full commuted value exempt.

EXAMPLE: Mr. Anand (non-government, receives gratuity) commutes 40% of his pension for a lump sum of Rs. 9,00,000. Full commuted value of 100% pension = Rs. 9,00,000 / 40% = Rs. 22,50,000. Exempt commuted pension = 1/3 × Rs. 22,50,000 = Rs. 7,50,000. Taxable commuted pension = Rs. 9,00,000 − Rs. 7,50,000 = Rs. 1,50,000.

National Pension System (NPS): Contributions to NPS during service are eligible for deduction under Sections 80CCD(1) and 80CCD(1B). On maturity/retirement: 60% of the corpus can be withdrawn as a lump sum — this 60% is fully exempt. The remaining 40% must be used to purchase an annuity, and the annuity income is taxable as salary/other sources when received.

4.8.3 Leave Encashment

Leave encashment is the cash payment received by an employee in lieu of earned (privilege) leave not availed during the course of employment or at the time of retirement.

Occasion of Leave Encashment	Government Employees	Non-Government Employees
During Service (while still employed)	FULLY TAXABLE	FULLY TAXABLE
At Retirement / Superannuation	FULLY EXEMPT — no limit	Exempt up to Least of: (a) Actual leave encashment, (b) 10 months' average salary, (c) Cash equivalent of leave balance (max 30 days per year of service), (d) Rs. 25,00,000
On Death in Service / Heirs receive after employee's death	FULLY EXEMPT	FULLY EXEMPT

'Average Salary' for leave encashment = average of salary of last 10 months preceding retirement or date of encashment. 'Salary' here = Basic + DA (if part of salary for retirement) + fixed commission. Earned leave entitlement is capped at 30 days per completed year of service for this computation.

4.8.4 Provident Fund

The Provident Fund is a long-term retirement savings scheme. Different types of PF attract different tax treatments at three stages: contribution, interest, and withdrawal — the EEE (Exempt-Exempt-Exempt) or EET (Exempt-Exempt-Taxable) classification.

Type of PF	Employee Contribution	Employer Contribution	Interest	Withdrawal
Statutory PF (SPF) [Govt. employees, universities]	Deductible u/s 80C	FULLY EXEMPT — no limit	FULLY EXEMPT	FULLY EXEMPT
Recognised PF (RPF) [Private sector —	Deductible u/s 80C	Exempt up to 12% of salary. Excess taxable.	Exempt up to 9.5% p.a. Interest in	Exempt if employee has served

EPFO]		Employer contributions exceeding Rs. 7.5 lakh (across EPF + NPS + Superannuation) are taxable.	excess is taxable.	continuously for 5+ years (or left due to ill health / employer's business closure). Otherwise taxable.
Unrecognised PF (URPF)	No deduction u/s 80C	Not taxable when contributed (but taxable on withdrawal)	Not taxable when accrued (but taxable on withdrawal)	Employee's own contribution: EXEMPT. Employer's contribution + interest: TAXABLE as salary. Employee's interest: TAXABLE as other sources.
Public Provident Fund (PPF) [Individual — SBI/Post Office]	Deductible u/s 80C up to Rs. 1.5 lakh	N/A — individual scheme, no employer contribution	FULLY EXEMPT u/s 10(11)	FULLY EXEMPT — classic EEE investment

4.9 DEDUCTIONS FROM SALARY

The income chargeable under the head ‘Salaries’ is computed after making the following deductions:

(1) Standard deduction [Section 16(ia)]
(2) Entertainment allowance [Section 16(ii)]
(3) Professional tax [Section 16(iii)]

(1) Standard Deduction: A flat deduction of Rs. 50,000 (enhanced from Rs. 40,000 from AY 2020-21) is available to every salaried employee and pensioner without any proof of expenditure. It is also

available under the New Tax Regime from AY 2024-25 (Rs. 75,000 for those opting New Regime from AY 2025-26 onwards as per Budget 2024).

(2) Entertainment Allowance: Entertainment allowance received is fully taxable and is first to be included in the salary and thereafter the following deduction is to be made from gross salary.

However, deduction in respect of entertainment allowance is available in case of Government employees only. The amount of deduction will be lower of:

(i) One-fifth of his basic salary or
(ii) Rs. 5,000 or
(iii) Entertainment allowance received.

Amount actually spent by the employee towards entertainment out of the entertainment allowance received by him is not a relevant consideration at all.

(3) Professional Tax on employment: Professional tax or taxes on employment levied by a State under Article 276 of the Constitution is allowed as deduction only when it is actually paid by the employee during the previous year. The total amount by way of professional tax payable in respect of any one person shall not exceed Rs. 2,500 per annum. However, the amount paid during the previous year can be more than Rs. 2,500 as the employee may have paid the professional tax of an earlier year during the previous year. If professional tax is reimbursed or directly paid by the employer on behalf of the employee, the amount so paid is first included as salary income and then allowed as a deduction u/s 16.

4.10 COMPUTATION OF TAXABLE SALARY

The computation of income under the head 'Salaries' follows a structured format. Below is the standard proforma:

Particulars	**Amount (Rs.)**
A. GROSS SALARY:	
Basic Salary	xxx

Fees/Commission	xxx
Bonus	Xxx
Dearness Allowance (DA) [if part of salary — fully taxable]	xxx
HRA received (full amount — before exemption)	xxx
Other Allowances (fully taxable — e.g., CCA, overtime)	xxx
Taxable Perquisites (per valuation rules)	xxx
Profits in Lieu of Salary [Section 17(3)]	xxx
Advance Salary / Arrears received during the year	xxx
Any other taxable component	xxx
TOTAL GROSS SALARY (A)	**XXX**
B. LESS: EXEMPTIONS UNDER SECTION 10:	
HRA exempt [Section 10(13A)] — as computed	(xxx)
LTC exempt [Section 10(5)]	(xxx)
Children's Education & Hostel Allowance [Section 10(14)]	(xxx)
Transport Allowance for disabled [Section 10(14)]	(xxx)
Leave encashment exempt [Section 10(10AA)]	(xxx)
Gratuity exempt [Section 10(10)]	(xxx)
Commuted pension exempt [Section 10(10A)]	(xxx)
VRS compensation exempt [Section 10(10C)] — up to Rs. 5 lakh	(xxx)

Any other Section 10 exemptions	(xxx)
TOTAL EXEMPTIONS (B)	**(XXX)**
C. NET SALARY (A − B)	**XXX**
D. LESS: DEDUCTIONS UNDER SECTION 16:	
Standard Deduction [Section 16(ia)]:	xxx
Entertainment Allowance [Section 16(ii)]:	(xxx)
Professional Tax [Section 16(iii)]: Actual professional tax paid (max Rs. 2,500/year)	(xxx)
TOTAL SECTION 16 DEDUCTIONS (D)	**(XXX)**
E. INCOME CHARGEABLE UNDER HEAD 'SALARIES' (C − D)	**XXX**

Illustration:

Mr. B. Baruah, employed in Delhi. FY 2025-26. Details:

Basic Salary: Rs. 80,000/month | DA (part of salary): Rs. 20,000/month | HRA: Rs. 35,000/month | LTC: Rs. 60,000 (actual travel cost Rs. 52,000) | Children's education allowance: Rs. 300/month (1 child) | Overtime allowance: Rs. 2,000/month | Professional tax paid: Rs. 2,400/year | Rent paid: Rs. 28,000/month | Free car provided (engine 1800cc, for mixed use). Compute the taxable salary of Mr. B. Baruah for the FY 2025-26.

Solution: Computation of Taxable salary of Mr. B. Baruah

Particulars	**Amount (Rs.)**
A. GROSS SALARY:	
Basic Salary (Rs. 80,000 × 12)	9,60,000
Dearness Allowance (Rs. 20,000 × 12)	2,40,000

HRA received (Rs. 35,000 × 12)	4,20,000
LTC received	60,000
Children's Education Allowance (Rs. 300 × 12)	3,600
Overtime Allowance (Rs. 2,000 × 12)	24,000
Perquisite: Motor Car (Rs. 2,400 × 12)	28,800
TOTAL GROSS SALARY	**20,36,400**
B. LESS: EXEMPTIONS U/S 10:	
HRA Exempt: Salary = Rs. 1,00,000/month. (a) Rs. 35,000; (b) Rs. 28,000 − Rs. 10,000 = Rs. 18,000; (c) 50% × Rs. 1,00,000 = Rs. 50,000 (Delhi = metro). Least = Rs. 18,000 × 12 = Rs. 2,16,000	(2,16,000)
LTC Exempt: Actual travel cost (lower of received and spent) = Rs. 52,000	(52,000)
Children's Education Allowance: Rs. 100 × 12 = Rs. 1,200 (1 child)	(1,200)
TOTAL EXEMPTIONS	**(2,69,200)**
C. NET SALARY (A − B)	**17,67,200**
D. LESS: DEDUCTIONS U/S 16:	
Standard Deduction [Section 16(ia)]	(50,000)
Professional Tax [Section 16(iii)]	(2,400)
TOTAL SECTION 16 DEDUCTIONS	**(52,400)**

E. INCOME UNDER HEAD 'SALARIES' (C − D)	**17,14,800**



CHECK YOUR PROGRESS

Q 3: What do you mean by profits in lieu of salary?

.....

.....

Q 4: Mention any two deductions from Salary.



4.11 LET US SUM UP

In this unit we have discussed the following:

- The Income Tax Act recognises five heads of income. Every item of income must be classified under the appropriate head as the computation rules differ for each head.
- 'Salary' under Section 17(1) is defined inclusively — it covers wages, pension, gratuity, fees, commission, perquisites, advance salary, leave encashment, and EPF contributions, among others.
- Allowances are classified as fully taxable, partially exempt or fully exempt.
- HRA exemption is the least of: (a) actual HRA, (b) rent paid minus 10% of salary, (c) 50% of salary for metros / 40% for other cities. Salary for this purpose = Basic + DA (if retirement-linked) + fixed % commission.
- Perquisites are taxable for all employees.
- Profits in lieu of salary under Section 17(3) include termination compensation, Keyman Insurance proceeds, and joining/exit payments — all taxable as salary.
- Retirement benefits: Government employees' gratuity and leave encashment are fully exempt; non-government employees' gratuity is exempt up to Rs. 20 lakh and leave encashment up to Rs. 25 lakh. Commuted pension is fully exempt for government employees; 1/3rd or 1/2 for others.
- Provident Fund: SPF and PPF are EEE (contributions deductible, interest and withdrawal exempt). RPF employer contribution is exempt up to 12% of salary and Rs. 7.5 lakh aggregate; withdrawal is exempt after 5 years of continuous service.
- Taxable salary = Gross Salary Less Section 10 exemptions Less Section 16 deductions (Standard Deduction, entertainment allowance for govt. employees, professional tax).

4.11 FURTHER READING

- Singhania, V.K. & Singhania, M. — Students' Guide to Income Tax (Taxmann Publications) — Latest Edition
- Ahuja, G.K. & Gupta, R. — Systematic Approach to Income Tax (Bharat Law House) — Latest Edition
- Income Tax Act, 1961 — Sections 15, 16, 17, 10(5), 10(10), 10(10A), 10(10AA), 10(13A) — Bare Act

- Income Tax Rules, 1962 — Rule 2A (HRA), Rule 2BB (Allowances), Rule 3 (Perquisite valuation)
- CBDT Circular No. 20/2015 — TDS on Salary: Obligations of employers
- Form 10E Filing Guide: www.incometax.gov.in (for Section 89 relief claims)
- EPFO Website: www.epfindia.gov.in — for EPF rules, withdrawal conditions, and UAN-related guidance

4.12 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: There are five heads of income for the purpose of charging of income tax. These heads are: Income from Salaries, Income from House Property, Profits and Gains of Business or Profession, Capital Gains and Income from Other Sources.

Ans to Q No 2: Types of allowances paid to employees are as follows:

- Dearness Allowances
- Entertainment Allowances
- Overtime Allowances
- Fixed Medical Allowances
- House Rent Allowances

Ans to Q No 3: Section 17(3) defines 'profits in lieu of salary' — these are payments received by an employee from the employer that are substitutes for or connected to salary, but are not regular salary payments. They are fully taxable as salary income (unless specifically exempt). The following are included:

- The amount of any compensation received by an employee — or his legal heirs — due to the termination of employment or modification of the terms of employment.
- Any payment received from a provident fund or other fund (to the extent it is not exempt under Section 10).
- Any sum received under a Keyman Insurance Policy — whether received as proceeds of the policy or as a bonus on such policy (if it has not been converted into an ordinary life insurance policy before the date of maturity/claim).

Any amount received by an employee before joining or after leaving employment that, but for this provision, would not be chargeable under 'Salaries' — for example, a joining bonus paid before the employment formally commences, or a golden handshake paid after retirement.

Ans to Q No 4: Two deductions from Salaries are as follows:

(1) Standard deduction [Section 16(ia)]

(2) Entertainment allowance [Section 16(ii)]

4.13 MODEL QUESTIONS

Short Answer Questions

1. Define 'salary' under Section 17(1). Name any five items included in the definition.
2. What is a 'perquisite'? Give three examples of perquisites that are taxable for all employees.
3. What is the Standard Deduction? Under which section is it provided? Is it available under the New Tax Regime?

Long Answer Questions

4. Explain the tax treatment of all types of allowances received by a salaried employee, with particular emphasis on House Rent Allowance. Illustrate the HRA computation with a numerical example.
5. Write a detailed note on the tax treatment of retirement benefits — gratuity, pension, leave encashment, and provident fund — distinguishing between government and non-government employees.
6. Explain the classification of perquisites under the Income Tax Act. What are the perquisites taxable for all employees? For which perquisites is there a distinction between 'specified' and other employees?
7. Prepare a detailed proforma for the computation of income under the head 'Salaries' with all deductions available under Section 16.

Practical / Numerical Questions

8. Mr. Gadhapani, a non-government employee (Gratuity Act applies), retires on 1st October 2025 after 29 years and 5 months of service. His last drawn salary (basic + DA forming part of salary) is Rs. 90,000/month. He receives: (a) Gratuity of Rs. 16,00,000, (b) Leave encashment of Rs. 8,50,000 (leave balance: 210 days; 10 months' average salary = Rs. 88,000/month), (c) Commuted pension: 50% commuted for Rs. 12,00,000 (and receives gratuity). Compute the taxable and exempt amounts for each retirement benefit.
9. Ms. Porinita works in Guwahati. For FY 2025-26: Basic: Rs. 70,000/month; DA (part of salary): Rs. 15,000/month; HRA: Rs. 40,000/month; LTC: Rs. 75,000 (actual travel cost Rs. 68,000); Children's education allowance: Rs. 400/month (2 children); Rent paid: Rs. 35,000/month; Overtime allowance: Rs. 3,000/month; Professional tax: Rs. 2,500/year. Compute income under the head 'Salaries'.
10. Mr. Golap Das receives arrears of Rs. 3,60,000 in FY 2025-26 relating to FY 2021-22. His total income in FY 2025-26 including arrears is Rs. 14,00,000. In FY 2021-22, his income excluding arrears was Rs. 8,50,000. Using the framework of Section 89(1), explain how relief will be computed (assume applicable slab rates).

UNIT 5: COMPUTATION OF INCOME FROM HOUSE PROPERTY

UNIT STRUCTURE

4.15 Learning Objectives

4.16 Introduction

4.17 Basis of Charge

4.18 Properties Exempt from Tax

4.19 Annual Value

4.20 Self-Occupied vs. Let Out Properties

4.21 Determination of GAV & NAV for Let Out Properties

4.22 Deductions u/s 24

4.23 Computation of Income from House Property

4.24 Let Us Sum Up

4.25 Further Reading

4.26 Answers To Check Your Progress

4.27 Model Questions

5.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Understand the legal framework of Income from House Property under Sections 22 to 27 of the Income Tax Act, 1961.
- Identify the conditions that must be satisfied for a property to be chargeable under this head
- Explain the concept of Annual Value and compute the Gross Annual Value (GAV) and Net Annual Value (NAV) for different categories of property.
- Compute Income from House Property for different categories of house property.

5.2 INTRODUCTION

The Income from House Property is one of the five major heads of Income which is described in Sections 22 to 27 of the Income Tax Act. In this Unit, we shall discuss the key concepts of House Property Income, taxability, exemptions, deductions etc..

Unlike salary (where an assessee is taxed on what he actually receives), Income from House Property is computed on the basis of the 'annual value' of the property — an estimate of what the property is inherently capable of earning — not necessarily what is actually earned. This means even a house that the owner lives in (a self-occupied property) is technically subject to this head of income, though the law provides for its annual value to be taken as Nil.

With rising property ownership, home loans, rental income, and multiple properties becoming increasingly common, the tax implications of house property decisions — renting out, self-occupation, joint ownership, inheritance — are everyday financial realities. This unit builds that understanding systematically, from first principles to comprehensive worked examples.

5.3 BASIS OF CHARGE

The process of computation of income under the head “Income from House Property” starts with the determination of annual value of the property. The concept of annual value and the method of determination is laid down in section 23. The annual value of any property comprising of buildings or lands appurtenant thereto of which the assessee is the owner is chargeable to tax under the head “Income from House Property”.

Conditions for Chargeability under the head “Income from House Property”

A house property is taxable under the head “Income from House Property” if the following conditions are satisfied.

I. Property should consist of any building or land appurtenant thereto.

(a) Buildings include not only residential buildings, but also factory buildings, offices, shops, godowns and other commercial premises.

(b) Land appurtenant means land connected with the building like garden, garage etc.

II. Assessee must be the owner of the property

(a) Owner is the person who is entitled to receive income from the property in his own right.

(b) The requirement of registration of the sale deed is not warranted.

(c) Ownership includes both free-hold and lease-hold rights.

(d) Ownership includes deemed ownership

(e) The person who owns the building need not also be the owner of the land upon which it stands.

(f) The assessee must be the owner of the house property during the previous year. It is not

material whether he is the owner in the assessment year.

(g) If the title of the ownership of the property is under dispute in a court of law, the decision as to who will be the owner chargeable to income tax under section 22 will be of the Income-tax Department till the court gives its decision to the suit filed in respect of such property.

III. Use of property

The property may be used for any purpose, but it should not be used by the owner for the purpose of any business or profession carried on by him, the profit of which is chargeable to tax.

The income earned by an assessee engaged in the business of letting out of properties on rent would be taxable as business income.

IV. Property held as stock-in-trade etc.

Annual value of house property will be charged under the head “Income from house property”, where it is held by the assessee as stock-in-trade of a business also.

5.4 EXEMPTED PROPERTIES

Certain properties, even if they satisfy all the conditions discussed above, are specifically exempted from income tax under Section 10.
Income from the following house properties are exempted from tax:

1. Any one palace or part thereof of an ex-ruler, provided the same is not let out [Sec. 10(19A)].
2. House property of a local authority [Sec. 10(20)].
3. House property of an approved scientific research association [Sec. 10(21)].
4. House property of an educational institution [Sec. 10(23C)].
5. House property of a hospital [Sec. 10(23C)].
6. House property of a person being resident of Ladakh [Sec. 10(26A)]
7. House property of a political party [Sec. 13A]
8. House property of a trade union [Sec. 10(24)]
9. A farm house [Sec. 10(1)]
10. House property held for charitable purpose [Sec. 11]
11. House property used for own business or profession [Sec. 22].

5.5 ANNUAL VALUE

The measure of charging income-tax under the head “Income from House Property” is the annual value of the property, i.e., the inherent capacity of a building to yield income. The expression ‘annual value’ has been defined in Section 23(1) of the Income-tax Act as:

1. The annual value of any property shall be deemed to be:
    a. the sum for which the property might reasonably be expected to be let from year to year; or
    b. where the property or any part of the property is let out and the rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable; or

c. where the property or any part of the property is let out and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (a), the amount so received or receivable.

Provided that the taxes levied by any local authority in respect of the property shall be deducted (irrespective of the previous year in which the liability to pay such taxes was incurred by the owner according to the method of accounting regularly employed by him) in determining the annual value of the property of that previous year in which such taxes are actually paid by him, i.e., municipal taxes will be allowed only in the year in which it was paid.

2. Where the property consists of a house or part of a house which is in the occupation of the owner for the purposes of his own residence; or cannot actually be occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place, he has to reside at that other place in a building not belonging to him, the annual value of such house or part of the house shall be taken to be Nil.

3. However, the above provisions shall not apply if:

   (a) the house or part of the house is actually let during the whole or any part of the previous year; or

   (b) any other benefit therefrom is derived by the owner.

4. Where the assessee has more than 2 Self Occupied Property then - Only two houses (any) will be considered as Self Occupied and the annual value of the house or houses, other than the house in respect of which the assessee has exercised an option to claim benefit of Self Occupied, shall be determined \ as if such house or houses had been deemed to be let out.

   Unrealized Rent: The amount of rent which the owner cannot realize shall be equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrevocable only if following conditions are satisfied:

(a) tenancy is bonafide;

(b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property; (c) the defaulting tenant is not in occupation of any other property of the assessee;

(d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfied the Assessing Officer that legal proceedings would be useless.

5.6 SELF-OCCUPIED VS. LET OUT PROPERTIES

In our previous sections, we have come across different categories of house property usages. The four categories of property usage are:

a. self-occupied,

b. let-out,

c. deemed to be let-out, and

d. partly let-out and partly self-occupied.

The tax treatment of a house property differs significantly depending on how the owner uses it.

a. Self-Occupied Property (SOP) [Section 23(2)]

A property is treated as 'self-occupied' if:

- It is occupied by the owner for purposes of his own residence, OR
- It cannot actually be occupied by the owner because — owing to his employment, business, or profession — he has to reside at another place in a building not belonging to him (e.g., an employee posted to a different city who lives in rented accommodation).

For a self-occupied property, the Annual Value is taken as NIL. This means there is no tax on the notional income from the self occupied property.

b. Let-Out Property (LOP)

A property that is rented out (wholly or partly) to a tenant during the whole or any part of the previous year is a 'let-out property'. For let-out properties:

- The Annual Value is NOT Nil — it is computed as the higher of the Expected Rent and the Actual Rent Received (subject to vacancy and unrealised rent adjustments).
- Both deductions under Section 24 — the 30% standard deduction and actual interest on borrowed capital — are available without any ceiling (the Rs. 2 lakh cap does NOT apply to let-out properties).
- If the property was let-out for only part of the year and self-occupied for the rest, the computation is done on a proportionate basis.

c. Partly Self-Occupied and Partly Let-Out Property

A single property may be:

- Let-out for a part of the year and self-occupied for the remaining part (e.g., the owner rents it out from April to September and lives in it from October to March).
- Partly used for self-occupation and partly let-out simultaneously (e.g., the owner lives on the first floor and lets out the ground floor to a tenant).

For a property that is let-out for part of the year and self-occupied for the rest:

- The Annual Value is determined as if it were let out for the whole year (i.e., the Expected Rent for the whole year is considered).
- The Actual Rent Received is the rent for the let-out period only.

d. Deemed Let-Out Property

When an assessee owns more than two residential properties, any property beyond two that is neither actually let-out nor self-occupied is treated as 'deemed to be let out'. For such a property:

- The Annual Value is computed as if it were let out at the market (fair) rent — i.e., the Expected Rent is taken as the GAV.
- There is no deduction for actual vacancy (since the notional rent itself is being assumed).
- All deductions under Section 24 are available.

The owner can choose which of his properties to treat as self-occupied (up to two) and which to treat as deemed let-out. The choice should be exercised optimally to minimise total tax liability — typically, properties with higher Expected Rent are chosen as self-occupied.

Parameter	Self-Occupied (up to 2)	Let-Out	Deemed Let-Out
Annual Value	NIL	Higher of ER and ARRR	Expected Rent (ER)
Municipal Taxes Deduction	Not applicable (AV = Nil)	Deductible if actually paid	Deductible if actually paid
Std. Deduction u/s 24(a)	Not applicable (NAV = Nil)	30% of NAV — no ceiling	30% of NAV — no ceiling
Interest u/s 24(b)	Up to Rs. 2 lakh (Rs. 30,000 if older loan/construction)	Actual interest — NO ceiling	Actual interest — NO ceiling
Unrealised Rent Deduction	N/A	Deductible if conditions met	N/A (notional rent only)

5.7 DETERMINATION OF GAV & NAV FOR LET OUT PROPERTIES

The determination of Gross Annual Value (GAV) for a let-out property follows a precise multi-step process prescribed under Section 23(1):

Step	Particulars	Description
1	Find Expected Rent (ER)	ER = Higher of (a) Municipal Value and (b) Fair Rent. If Standard Rent applies (Rent Control Act) and is lower than ER, cap ER at Standard Rent.

2	Find Actual Rent Received or Receivable (ARRR)	ARRR = Total rent actually received or due during the year for the period the property was let out. Exclude unrealised rent (if conditions u/s 25AA met).
3	Compare ER and ARRR	If ARRR ≥ ER → GAV = ARRR. If ARRR < ER due to vacancy only → GAV = ARRR. If ARRR < ER for any other reason → GAV = ER.
4	Apply Vacancy Deduction (if applicable)	If property remained vacant for whole/part of the year and ARRR < ER solely on account of vacancy, then GAV = ARRR (vacancy loss absorbed). Not a separate deduction from GAV.
5	GAV = Result from Step ¾	This is the final Gross Annual Value before deducting municipal taxes.

Illustration 1:

Mr. Bora has a flat in Guwahati whose Fair Rent is Rs. 25,000/month and Municipal Value is Rs. 22,000/month. He rented it out from April to September 2025 (6 months) at Rs. 24,000/month. He occupied it himself from October 2025 to March 2026 (6 months). Calculate GAV.

Solution:

Expected Rent = Higher of Rs. 22,000 and Rs. 25,000 = Rs. 25,000/month × 12 = Rs. 3,00,000.

Actual Rent = Rs. 24,000 × 6 = Rs. 1,44,000.

GAV = Higher of Rs. 3,00,000 and Rs. 1,44,000 = Rs. 3,00,000.

Note: Vacancy deduction does NOT apply here since the vacancy was due to owner's self-occupation, not inability to find a tenant.

If the owner could not realise a part of the rent from a tenant, such unrealised rent is deductible from the actual rent receivable — but only if ALL of the following conditions are satisfied:

1. The tenancy is bonafide.
2. The defaulting tenant has vacated the property, or steps have been taken to compel him to vacate.
3. The defaulting tenant does not continue to occupy any other property of the assessee.

4. The assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent, OR has satisfied the Assessing Officer that such legal proceedings would be useless (e.g., the tenant is untraceable or has no assets).

If unrealised rent is subsequently recovered in a later year (even if no longer owning the property), the recovered amount is taxable as income from house property in the year of recovery [Section 25AA].

Again, if a let-out property remained vacant during the whole or any part of the previous year, and due to such vacancy, the actual rent received or receivable is less than the Expected Rent, then the actual rent (and not the higher Expected Rent) is taken as the GAV. The vacancy allowance is NOT a separate deduction — it operates by reducing the GAV itself to the actual rent level.

Illustration 2:

Mr. Deuri's property:

Fair Rent = Rs. 30,000/month,

Municipal Value = Rs. 27,000/month.

Property was vacant from April to June 2025 (3 months).

Let out at Rs. 28,000/month from July 2025 to March 2026 (9 months). Determine GAV.

Solution:

ARRR = Rs. 28,000 × 9 = Rs. 2,52,000.

ER = Rs. 30,000 × 12 = Rs. 3,60,000.

Since ARRR < ER solely due to vacancy, GAV = ARRR = Rs. 2,52,000.

5.8 DEDUCTIONS U/S 24

Section 24 provides for two deductions from the Net Annual Value to arrive at the taxable income from house property. These deductions are available only under the Old Tax Regime. Under the New Tax Regime (Section 115BAC), only interest on home loan for let-out property (with no ceiling) is deductible; the Rs. 2 lakh interest deduction for SOP is NOT available under the New Regime.

a. Standard Deduction [Section 24(a)]

A standard deduction of 30% of the Net Annual Value (NAV) is allowed as a flat deduction without any requirement to prove actual expenditure. It is available only for let-out and deemed let-out properties

b. Interest on Borrowed Capital [Section 24(b)]

Interest paid on money borrowed for the purpose of purchase, construction, repair, renewal, or reconstruction of a house property is deductible under Section 24(b). This is one of the most significant deductions available to property owners with home loans. The rules differ based on the type of property and the purpose of borrowing:

Property Type & Purpose	Maximum Deduction	Conditions
Self-Occupied Property — Loan for purchase/construction taken on or after 01.04.1999 and construction completed within 5 years	Rs. 2,00,000 per year	Certificate from lender required. Completion within 5 years from end of FY of loan.
Self-Occupied Property — Loan for purchase/construction taken before 01.04.1999, OR construction not completed within 5 years	Rs. 30,000 per year	Lower limit applies if loan is older or construction is delayed beyond 5 years.
Self-Occupied Property — Loan for repair, renewal, or reconstruction (any date)	Rs. 30,000 per year	Rs. 2 lakh ceiling does not apply to repair/renovation loans for SOP.
Let-Out or Deemed Let-Out Property — Any loan purpose	ACTUAL interest paid — NO ceiling	No upper limit. Full interest deductible. Can result in a loss under this head.

Interest paid during the period before the year in which construction is completed (called the 'pre-construction period') is not deductible in the year of payment. Instead, it is accumulated and allowed as a deduction in five equal annual instalments, beginning from the year in which construction is completed.

5.9 COMPUTATION OF INCOME FROM HOUSE PROPERTY

In this section, we shall discuss about the computation of Income from House Property for different categories of Property. We would try to understand the computation with the help of proforma designed for each category of Property.

i) Property Let Out throughout the previous year

Particulars	Amount (Rs.)
1. Gross Annual Value (GAV)	
a. Municipal Value of the property	xxx
b. Fair Rent of the property	xxx
c. Higher of (a) and (b) = Expected Rent (ER)	xxx
d. Standard Rent (under Rent Control Act, if applicable)	xxx
e. Expected Rent = Lower of (c) and (d)	xxx
f. Actual Rent Received / Receivable (ARRR)	xxx
g. Unrealised Rent (deducted if conditions u/s 25AA met)	(xxx)
h. ARRR after deducting unrealised rent	xxx
GAV = Higher of (e) and (h) [subject to vacancy adjustment]	**XXX**
2. LESS: Municipal Taxes paid by owner during the year	(xxx)
3. NET ANNUAL VALUE (NAV) [1 − 2]	**XXX**
4. LESS: Deductions u/s 24:	
a. Standard Deduction @ 30% of NAV [Section 24(a)]	(xxx)
b. Interest on borrowed capital [Section 24(b)] — Actual (no ceiling for LOP)	(xxx)
5. INCOME FROM HOUSE PROPERTY [3 − 4]	**XXX**
(Positive = Taxable Income; Negative = Loss from House Property)	

ii) Self-Occupied Properties (SOP) or Unoccupied Properties

Particulars	Amount (Rs.)
1. Annual Value of Self-Occupied Property [Section 23(2)]	**NIL**
2. NET ANNUAL VALUE (NAV)	**NIL**
3. LESS: Deductions u/s 24:	
a. Standard Deduction @ 30% of NAV [30% × Nil = Nil]	NIL
b. Interest on borrowed capital [Section 24(b)]:	
– Loan on/after 01.04.1999 for purchase/construction, completed within 5 years: Max Rs. 2,00,000	(up to 2,00,000)
– Loan before 01.04.1999 or construction beyond 5 years: Max Rs. 30,000	(up to 30,000)
– Repair/renovation loans: Max Rs. 30,000	(up to 30,000)
4. INCOME FROM SELF-OCCUPIED HOUSE PROPERTY [3 − 4]	**(XXX) LOSS**
(Always a loss or Nil — since NAV = Nil and interest creates a loss)	

Illustration 3:

Ms. Kakoli owns a flat in Khanapara let out throughout FY 2025-26.

Municipal Value: Rs. 2,40,000 p.a.

Fair Rent: Rs. 2,80,000 p.a.

Standard Rent: Rs. 2,60,000 p.a. (Rent Control applies)

Actual Rent Received: Rs. 25,000/month (Rs. 3,00,000 p.a.)

Unrealised Rent: Rs. 25,000 (tenant defaulted for 1 month; all Section 25AA conditions

satisfied)

Municipal Taxes paid by Ms. Kakoli: Rs. 18,000

Interest on home loan: Rs. 3,60,000 p.a.

Compute the Income from House Property of Ms. Kakoli for the AY 2026-27.

Solution 3:

Computation of Income from House Property of Ms. Kakoli for the AY 2026-27

Particulars	**Amount (Rs.)**
Expected Rent = Higher of Municipal Value (Rs. 2,40,000) and Fair Rent (Rs. 2,80,000) = Rs. 2,80,000; capped at Standard Rent = Rs. 2,60,000	2,60,000
ARRR = Rs. 3,00,000 − Rs. 25,000 (unrealised rent) = Rs. 2,75,000	2,75,000
GAV = Higher of ER (Rs. 2,60,000) and ARRR (Rs. 2,75,000) = ARRR (since ARRR > ER)	**2,75,000**
Less: Municipal Taxes paid	(18,000)
NET ANNUAL VALUE (NAV)	**2,57,000**
Less: Standard Deduction @ 30% of Rs. 2,57,000 [Section 24(a)]	(77,100)
Less: Interest on Home Loan [Section 24(b)] — actual, no ceiling for LOP	(3,60,000)
INCOME FROM HOUSE PROPERTY (LOSS)	**(1,80,100)**

Illustration 4:

Mr. Nilakantha owns a house in Tezpur, self-occupied throughout FY 2025-26.

He took a home loan of Rs. 40 lakhs from SBI on 01.07.2020 @ 8.5% p.a. for purchase.

Construction/purchase was completed by 30.09.2021.

Interest paid during FY 2025-26: Rs. 3,40,000.

Pre-construction interest (July 2020 to March 2021 = 9 months): 8.5% × Rs. 40L × 9/12 = Rs. 2,55,000.

Pre-construction installment (deductible over 5 years from FY 2021-22): Rs. 2,55,000 / 5 = Rs. 51,000/year.

Compute the Income from House Property of Mr. Nilakantha for the AY 2026-27.

Solution 4:

Computation of Income from House Property of Mr. Nilakantha for the AY 2026-27.

Particulars	**Amount (Rs.)**
Annual Value of Self-Occupied Property [Section 23(2)]	**NIL**
NET ANNUAL VALUE (NAV)	**NIL**
Less: Standard Deduction @ 30% of Nil [Section 24(a)]	NIL
Less: Interest on home loan [Section 24(b)]:	
Current year interest	3,40,000
Add: Pre-construction instalment (1/5 of Rs. 2,55,000)	51,000
Total deductible interest	3,91,000
Subject to maximum limit for SOP (loan post 01.04.1999, completed within 5 years): Rs. 2,00,000	(2,00,000)

INCOME FROM SELF-OCCUPIED HOUSE PROPERTY (LOSS u/s 24(b))	**(2,00,000)**

Illustration 5:

Mr. Baruah owns two houses in FY 2025-26.

House A (Jorhat — Self-Occupied): Interest on home loan = Rs. 1,80,000 p.a.

House B (Majuli — Let-Out for full year): Fair Rent = Rs. 18,000/month | Municipal Value = Rs. 16,000/month

Actual Rent = Rs. 17,000/month | Municipal Taxes paid = Rs. 15,000 | Interest on loan = Rs. 90,000.

Compute the Income from House Property of Mr. Baruah for the AY 2026-27.

Solution:

Computation of Income from House Property of Mr. Baruah for the AY 2026-27.

Particulars	**House A — SOP (Rs.)**	**House B — LOP (Rs.)**
Annual Value / GAV	**NIL**	2,16,000 (Higher of ER Rs.2,16,000 and ARRR Rs.2,04,000 — GAV=ER since ARRR<ER not due to vacancy)
Less: Municipal Taxes	N/A	(15,000)
Net Annual Value (NAV)	**NIL**	**2,01,000**
Less: Standard Deduction u/s 24(a)	NIL	(60,300)

Less: Interest u/s 24(b)	(1,80,000)	(90,000)
Income / (Loss) from House Property	**(1,80,000)**	**50,700**
NET INCOME FROM HOUSE PROPERTY (both combined)	**(1,80,000) + 50,700 = (1,29,300) LOSS**	

CHECK YOUR PROGRESS
1. State the conditions necessary for a property to be chargeable under the head 'Income from House Property'? 2. What are the deductions available under Section 24?

5.10 LET US SUM UP

In this unit we have discussed in details about the computation of income from house property under Sections 22–27 of the Income Tax Act, 1961. The important points were as follows:

- Income from house property is charged on the 'Annual Value' — the inherent earning capacity of the property — not necessarily on actual rental income received.
- The following conditions must be satisfied:
  (a) the property must be a building or appurtenant land,
  (b) the assessee must be the owner (including deemed owner under Section 27), and
  (c) the property must not be used by the owner for his own business/profession.
- Properties exempt from tax under this head include farmhouses on agricultural land, income of local authorities, charitable trusts (Section 11), and self-occupied residential properties (up to two — Annual Value treated as Nil).
- GAV of a let-out property = Higher of Expected Rent (higher of Municipal Value and Fair Rent, capped at Standard Rent under Rent Control) and Actual Rent Received/Receivable (after deducting unrealised rent if all Section 25AA conditions are met). Vacancy adjustment is absorbed in the GAV itself.
- Municipal taxes deductible from GAV only if (a) borne by the owner and (b) actually paid during the year — giving NAV.
- Section 24 provides two deductions from NAV:

(a) 30% standard deduction (for LOP only; NIL for SOP since NAV = Nil) and

(b) interest on borrowed capital (capped at Rs. 2 lakh for SOP loans post 01.04.1999; unlimited for LOP; pre-construction interest allowed in 5 equal instalments).

5.11 FURTHER READING

- Singhania, V.K. & Singhania, M. — Students' Guide to Income Tax (Taxmann Publications) — Latest Edition
- Ahuja, G.K. & Gupta, R. — Systematic Approach to Income Tax (Bharat Law House) — Latest Edition
- Income Tax Act, 1961 — Sections 22, 23, 24, 25, 25AA, 25B, 26, 27 — Bare Act
- Income Tax Rules, 1962 — Rules relevant to House Property computation
- CBDT Circular No. 08/2019 — Clarification on two self-occupied property benefit (Finance Act, 2019)
- NHB (National Housing Bank) website: www.nhb.org.in — for housing loan interest rates and PMAY details
- e-Filing Portal — ITR-2 Schedule HP (House Property) for reference: www.incometax.gov.in

5.12 ANSWERS TO CHECK YOUR PROGRESS

1. The conditions necessary for a property to be chargeable under the head 'Income from House Property' are as follows:

   (a) Property must consist of buildings or lands appurtenant thereto;

   (b) Assessee must be the owner of the property (including deemed owner under Section 27);

   (c) The property must not be used by the owner for the purposes of any business or profession, the profits of which are chargeable to tax.
2. Section 24 deductions:

   (a) Standard Deduction @ 30% of NAV

   (b) Interest on borrowed capital

5.13 MODEL QUESTIONS

Short Answer Questions

1. What is 'Annual Value'? How does it differ from actual rent received?
2. Define 'Gross Annual Value'. How does the vacancy allowance affect the GAV of a let-out property?
3. Explain the concept of 'pre-construction period interest' and how it is deductible under Section 24(b).

Long Answer Questions

4. Explain the basis of charge of income from house property under Section 22. What are the conditions to be satisfied? Discuss the properties exempt from this head of income.

5. Distinguish between Self-Occupied Property, Let-Out Property, and Deemed Let-Out Property. What are the tax implications of each category?
6. Explain in detail the method of computing the Gross Annual Value (GAV) and Net Annual Value (NAV) for a let-out property. How are unrealised rent and vacancy loss treated in the computation?
7. Write a detailed note on the deductions available under Section 24. What are the conditions for claiming interest on borrowed capital? How is pre-construction interest treated?

Practical / Numerical Questions

8. Ms. Banamali owns a house in Tinsukia. Municipal Value: Rs. 3,00,000 p.a. Fair Rent: Rs. 3,60,000 p.a. and Standard Rent is Rs. 3,30,000 p.a. The house was let out for the whole year at a rent of Rs. 31,000/month. Municipal taxes of Rs. 24,000 were paid by Banamali during the year. Unrealised rent of Rs. 31,000 (1 month) — all conditions under Section 25AA are satisfied. Interest on home loan: Rs. 2,80,000 p.a. Compute her income from house property.
9. Mr. Khanindra owns two houses: (a) House P in Bongaigaon: Self-occupied; Home loan interest = Rs. 1,75,000 p.a. (b) House Q in Guwahati: Let out for 9 months at Rs. 18,000/month; vacant for 3 months. Fair Rent = Rs. 2,50,000 p.a., Municipal Value = Rs. 2,20,000 p.a., Municipal taxes paid = Rs. 12,000, Interest on loan = Rs. 1,20,000 p.a. Compute income from both house properties.
10. Mr. Mudoi owns three residential properties in FY 2025-26 — none rented out. Fair Rents: House 1 = Rs. 3,60,000 p.a., House 2 = Rs. 2,40,000 p.a., House 3 = Rs. 1,80,000 p.a. Interest on home loan for House 3 = Rs. 2,50,000 p.a. Advise Mr. Mudoi on which two houses to designate as self-occupied to minimise his tax liability. Compute the income from house property of Mr. Mudoi for the AY 2026-27.

UNIT 6: PROFITS AND GAINS FROM BUSINESS AND PROFESSION

UNIT STRUCTURE

6.1 Learning Objectives

6.2Introduction

6.3Meaning of Business and Profession

6.4 Income Taxable under PGBP (Sec 28)

6.5 Computation of PGBP (Section 29)

6.6 Statutory Deductions under PGBP (Sections 30–37)
6.6.1 Section 30 : Rent, Rates, Taxes, Repairs and Insurance of Building
6.6.2 Section 31 :Repairs and Insurance of Plant & Machinery and Furniture
6.6.3 Section 32 : Depreciation
6.6.4 Section 33AB : Tea, Coffee and Rubber Development Account
6.6.5 Site Restoration Fund (Petroleum & Natural Gas)
6.6.6 Section 35 : Scientific Research
6.6.7 Section 35AD : Specified Business Deduction
6.6.8 Section 36 : Other Specific Deductions
6.6.9 Section 37 : General (Residuary) Deduction

6.7 Presumptive Taxation

6.8 Let Us Sum Up

6.9 Answers to Check Your Progress

6.10 Further Readings

6.10 Model Questions

6.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Explain the meaning and scope of Profits and Gains from Business or Profession (PGBP) under the Income-tax Act, 1961.
- Distinguish between business and profession as defined under the Act.

- Identify incomes chargeable under Section 28.
- Understand the method of computation of business income under Section 29 read with Sections 30 to 43D.
- Analyse allowable and disallowable deductions, including depreciation under Section 32.
- Apply the provisions of presumptive taxation under Sections 44AD, 44ADA, and 44AE.

6.2 INTRODUCTION

The "Profits and Gains of Business or Profession" (PGBP) is a fundamental category under the Income-tax Act that taxes earnings derived from any trade, manufacturing activity, or specialized professional practice. Governed by Sections 28 to 44D, the scope of PGBP is intentionally broad; it captures not only the standard operating profits of a business but also incidental receipts, compensation, and specific benefits tied to commercial activities. Instead of simply taxing gross revenue, the law requires a structured computation process under Section 29, where taxpayers begin with their book profit and apply specific statutory rules to calculate their true taxable income.

6.3 MEANING OF BUSINESS AND PROFESSION

Income that arises from the profits and gains of a business or a profession is taxed under the head “Profits and gains of Business or Profession” as per Sections 28 to 44D of the Income – tax Act. These provisions determine what kinds of business and professional income are chargeable to tax and how they should be computed.

Under Section 2(13) of the Income-tax Act, business includes any form of trade, commerce, manufacturing activity, or any venture of a similar nature. Essentially, it refers to any regular economic activity carried on with the aim of earning profits.

A profession denotes an occupation undertaken for earning a living or gains that predominantly relies on intellectual expertise and specialized skills rather purely manual labour. Examples include careers like doctors, lawyers, architects, chartered accountants, engineers, and tax practitioners where specialized knowledge and judgment are essential.

6.4INCOME TAXABLE UNDER PGBP (SECTION 28)

The head PGBP includes every type of income that arises from carrying on a business activity or practicing a profession during the year. The scope of this head is wide and covers not only the regular profits from trade or professional work but also several related receipts connected with such activities. The following incomes are generally taxed under PGBP:

1. Profit from business or professional activities

Any surplus earned from trade, commerce, manufacturing, or professional services is taxable under this head.

2. Compensation related to business agreements

Money received for the cancellation, termination, or modification of contracts like agency, management, or dealership agreements is treated as business income.

3. Income of professional or trade organizations

Earnings of associations or institutions from services provided to their members fall under this category.

4. Government incentives and export benefits

Receipts such as duty drawback, cash assistance, subsidies, and export incentives linked to business operations are included.

5. Benefits or facilities arising from business or profession

The value of any benefit, whether received in cash or kind, which arises due to business or professional activity, is taxable.

6. Remuneration received by a partner from a firm

Salary, bonus, commission, or interest received by a partner from the partnership firm is taxed as business income in the partner's hands.

7. Income from speculative transactions

Profits from certain speculative dealings where actual delivery of goods or shares does not occur are covered here.

8. Recovery of previously allowed deductions

Amounts recovered from bad debts or expenses that were earlier claimed as deductions are taxable.

9. Proceeds from Keyman Insurance Policy

Any sum received under such a policy is treated as business income.

10. Other incidental business receipts

Any income that is closely connected with the business or profession, even if not directly from the main activity, is also included.

PGBP covers not only regular profits from business or profession but also related receipts and benefits. Any income closely connected with business or professional activity is taxable under this head.

6.5 COMPUTATION OF PGBP (SECTION 29)

After identifying the income taxable under the head PGBP (section 28), the next important step is to understand how such income is calculated. This is provided in section 29 of the Income Tax Act 1961. It does not list any deductions or expenses by itself. Instead, it lays down the rule that the business or professional income mentioned in Sec 28 must be computed strictly in accordance with the provisions contained in Sections 30 to 43D.

Process of calculating PGBP income is mentioned as under:

1. Start with the book profit
2. Apply rules from sections 30-43D
3. Compute final income

The proforma below represents the practical application of Section 29, which mandates that business income must be computed in accordance with Sections 30 to 43D of the Income-tax Act, 1961.

CALCULATION OF INCOME FROM BUSINESS/ PROFESSION		
PARTICULARS	**AMOUNT (RS)**	**SECTION REFERENCE**
Net Profit (As per P/L Account)	****	
Add: Expenses debited but not allowed		
Income tax, penalty, fines	***	Sec 40 (a) (ii)
Personal Expenses		Sec 37
Cash Payment disallowed		Sec 40 A (3)
Provision for expenses		
Excess depreciation charged in books		Sec 32
Other inadmissible expeneses		Sec 30-37/ 40/ 40A
Total Additions		
Less: Expenses allowed but not debited		
Depreciation as per Income Tax Rules	***	Sec 32
Scientific Research Expenditure	***	Sec 35
Eligible business expenses omitted	***	Sec 37
Total Deductions	***	
INCOME FROM PGBP		Sec 29

6.6 STATUTORY DEDUCTION UNDER PGBP (SEC 30-37)

These sections classify and regulate business expenditures such as rent, repairs, depreciation, research expenses and other necessary business outlays, thereby ensuring that only legitimate and lawful expenses are deducted while arriving at the taxable business income.

6.6.1 Section 30: Rent, Rates, Taxes, Repairs & Insurance Building

	Rent	**Rates &Taxes**	**Insurance**	**Revenue Repair**	**Capital Repair**
Owner	Not allowed	Allowed	Allowed	Allowed	Not allowed
Tenant	Allowed	Allowed	Allowed	Allowed	Not allowed

6.6.2 Section 31: Insurance& Repair of Plant & Machinery and Furniture

	Rent	Insurance	Revenue Repair	Capital Repair
Owner	Not allowed	Allowed	Allowed	Not allowed
Tenant	Allowed (Sec37)	Allowed	Allowed	Not allowed

Notes:

1. Expenses u/s 30 & 31 allowed only if asset is used for Profits and Gains from Business & Profession.
2. Capital repair not allowed as deduction as it will be added to cost of asset.
3. If a firm runs its business in the premise owned by its partner, the rent payable to the partner will be allowed to the extent it is reasonable and is not excessive.

6.6.3 Section 32 Depreciation

1. Conditions to claim Depreciation

(i) Asset should be used for business/ profession purposes (active or passive)

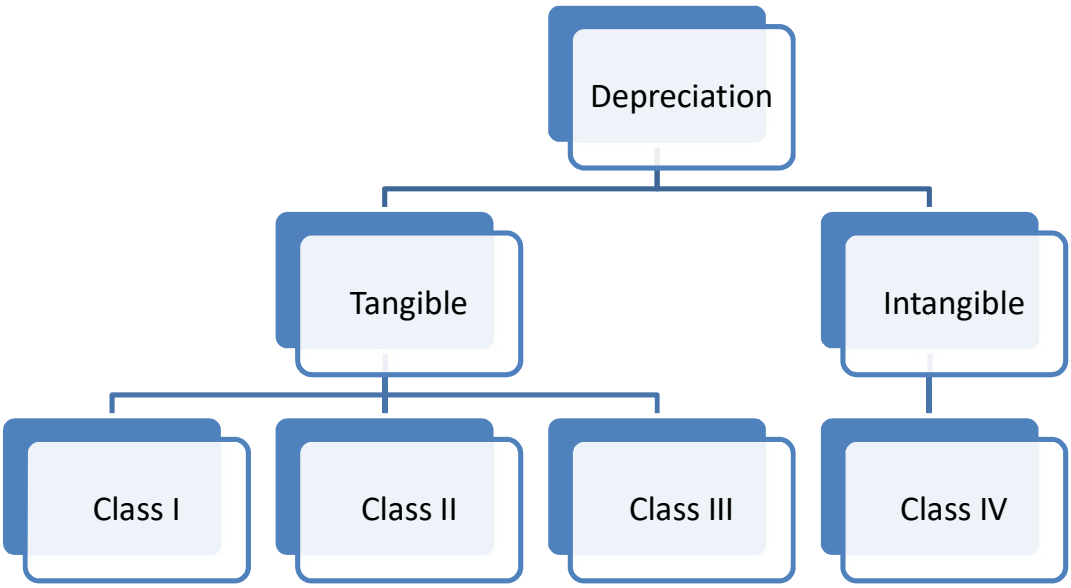
(ii) Assessee should be owner of such asset (wholly or partly)

Notes:

1. Depreciation is allowed if assessee is beneficial owner
2. In case of lease, depreciation is always claimed by the lessor whether it is financial lease or operating lease (CBDT circular)
3. In case of hire purchase, assessee gets the ownership only after the payment of last instalment but he can claim depreciation from beginning, assuming assessee is the owner from beginning.
4. Depreciation on asset partially owned by the assessee shall be allowed to him for his share in asset.
5. In case of stand by machinery and emergency spares, the depreciation shall be allowed even if they are ready for use & not put to use.

2. Classification of Depreciable Assets

Depreciation is decline in the estimated economic service potential of capital as a result wear and tear of through use or obsolescence.



Business assets are segregated under classes for 4 purpose of claiming depreciation.

Class 1 -Buildings

Examples:

Office building, shop, factory

Godown, warehouse

Staff quarters

Temporary sheds (wooden structures)

Class 2 - Furniture & Fittings

Examples:

Tables, chairs, desks

Racks, shelves, cupboards

Electrical fittings, fans, lights

Class 3 - Plant & Machinery

Examples:

- Manufacturing machines
- Computers, printers
- Office equipment
- Business vehicles
- Tools and instruments

Class 4 - Intangible Assets

Examples:

- Patents
- Trademarks
- Copyrights
- Licenses
- Franchises
- Business rights

3. Rates o Depreciation (WDV method) (Block of Asset System)

S. No	Assets	Rate
1.	Building (includes roads, bridge, well and tube wells)	
	(i) Residential use (except hotels)	5%
	(ii) Other use	
	(iii) Temporary or wooden structure	10%
		40%
2.	Furniture & Fittings (include electrical fittings like fans, wires, switches etc)	10%
3.	Plant & Machinery	
	(i) Motor Vehicles	15%
	- Acquired & put to use between 23.08.19 to 31.03.20	30%
		30%
	(ii) Motor vehicles (Lorries, buses, taxi) used in Hire Business	45%
	- Acquired & put to use between 23.08.19 to 31.03.20	20%
		40%
	(iii) Ships, Vessels, Speed Boats	

	(iv) Aeroplanes, Aeroegines (v) Computer & Computer software (vi) Books (include annual publication or used in the library) (vii) Pollution Control Equipments (viii) Windmills & its equipment installed before 1/04/14 -Windmills & its equipment installed on or after 1/04/14 (ix) Renewable Energy Devices (include E-Vehicles) (x) Oil wells (xi) Other P& M	40% 40% 40% 15% 40% 40% 15% 15%
4.	Intangible Assets	25%

Notes:

1. Mandatory to claim depreciation for all assessee
2. EPABX & Mobile phone are not computers; hence depreciation @40% is not eligible
3. Intangible assets include know- how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature but other than goodwill of business and profession
4. Depreciation rate for computer accessories is 40% i.e. UPS, printer, scanners etc.
5. Depreciation allowed when asset actually put to use& not ready to use
6. As per Sec 43 (3) plant includes ships, books, scientific apparatus & surgical equipment used for business or profession but does not include Tea bushes, livestock, building, furniture.

4. Method of Depreciation

As we all know that there are mainly two methods of depreciation. These are, Written Down Value Method and Straight-Line Method. For **Regular businesses**, depreciation is calculated based on the total block value (block WDV method). On the other hand, in Power generating businessesone can take depreciation the simpler way (straight line on cost) or the usual WDV way whichever benefits more, but once chosen it sticks.

5. Calculation of Depreciation (WDV method)

PARTICULARS	AMOUNT (Rs)
Opening WDV of block Add: Actual cost of asset acquired during PY - Put to use 180 days or more (up to 3rd Oct) - Put to use less than 180 days (on or after 4th Oct) - Acquired but not put to use	****
Less: Money payable (Selling price of asset) Less: WDV of assets transferred in Slump sae (compute WDV of asset assuming this is only asset in block)	***
** WDV of Block for the purpose of Depreciation Less: Depreciation actually allowed	
Closing WDV of Block	***

Notes:

1. If asset acquired during current PY & not put to use then depreciation shall not be allowed for such asset but that asset should be added to block of asset. If the asset is put to use 180 days or more (up to 3rd Oct), half rate of depreciation will be allowed and if the asset is put to use less than 180 days (on or after 4th Oct) full rate of depreciation will be allowed.
2. Actual sale price of asset shall be reduced and not the FMV of asset sold.

6.6.4 Section 33AB: Tea Coffee and Rubber Development Account

This deduction is available specifically to assessees in India who are engaged in the business of growing and manufacturing tea, coffee, or rubber. To claim this benefit, the assessee must deposit an amount into a Special Account with NABARD or a deposit scheme approved by the Tea, Coffee, or Rubber Board. This deposit must be made within six months from the end of the previous year or before the due date of filing the Income Tax Return, whichever is earlier. The quantum of deduction allowed is the least of the following two amounts:

(1) the amount actually deposited, or

(2) 40% of the profits of such business (computed before this deduction).

However, if the deposited money is later withdrawn and used for non-specified purposes (such as personal expenses or buying a car), that amount will be treated as taxable business income in the year of withdrawal.

6.6.5 Site Restoration Fund (Petroleum & Natural Gas)

This deduction is available to assesses engaged in the business of prospecting, extracting, or producing petroleum or natural gas in India, provided they have entered into an agreement with the Central

Government. To avail of this benefit, the assessee must deposit an amount into a Special Account (such as with the State Bank of India) or a Site Restoration Account under a scheme approved by the relevant Ministry. The quantum of deduction allowed is the lesser of two amounts:

(1) the actual amount deposited in the account, or

(2) 20% of the profits of such business (computed before making this deduction).

However, a crucial tax point to remember is that if any amount is withdrawn from this account and not used for site restoration, it will be treated as taxable business income in the year of withdrawal.

6 Section 35: Scientific Research

The government provides high incentives to promote R&D in India, allowing for significant deductions on scientific research expenses. For research carried on by the assessee (in-house), a 100% deduction is allowed on both revenue expenditure (such as scientists' salaries and raw materials) and capital expenditure (such as lab equipment and buildings). However, it is important to note that expenditure on land is never deductible. Additionally, if the assessee contributes to outside institutions, such as approved research associations, universities, or IITs, or pays for social science or statistical research, a 100% deduction is also allowed on the amount paid. A simple rule to remember is that generally, genuine spending on scientific research—whether capital or revenue—qualifies for a 100% deduction.

Telecom License & Spectrum Fees (Amortization)

Since telecom license and spectrum fees involve huge one-time payments that provide benefits for many years, the entire amount cannot be deducted in a single year; instead, it must be amortized or spread out.

Section 35ABB deals with the Telecom License Fee, which is the payment made for the license to operate telecom services. The deduction for this fee is calculated by dividing the actual payment by the total number of years the license is valid.

Section 35ABA covers the Spectrum Fee, which is the payment for the right to use spectrum (airwaves). Like the license fee, the cost of the spectrum is amortized over its useful life, with the annual deduction calculated as the total spectrum fee divided by the useful life of the spectrum.

6.6.7 Section 35AD: Specific Deduction (The “Golden” Deduction)

To boost infrastructure growth, the government provides a massive incentive known as the "Golden Deduction" for specific industries. Under Section 35AD, eligible businesses are allowed a **100% deduction** of their capital expenditure in the very first year of operation. However, there is a strict exception: expenditure incurred on **land, goodwill, and financial instruments** is **not** eligible for this deduction. Some common examples of "Specified Businesses" that qualify include **cold chain facilities**, **warehousing** for agricultural produce or sugar, laying and operating **cross-country pipelines** (for gas or oil), and building and operating **hotels** (2-star or above) or **hospitals** (with 100 beds or above).

A **crucial tax point** to remember regarding this section is the treatment of losses. If a Section 35AD business incurs a **loss**, it can **only** be set off against the profits of **another Section 35AD business**. It

strictly **cannot** be adjusted against normal business profits, meaning the loss must be carried forward until it can be set off against specified business profits in the future.

6.6.8 Section 36: Other Specific Deduction

This section covers common business expenses that are allowed as deductions if specific conditions are met. Insurance premiums paid for stocks, cattle, or the health of employees are deductible, with the strict condition that health insurance premiums must be paid by any mode other than cash. Bonus or commission paid to employees is allowed if it is for services rendered and not merely a distribution of profits or dividends. Similarly, interest on borrowed capital is deductible provided the loan was taken specifically for business purposes. A crucial rule applies to employer's contributions to PF or superannuation funds, which are allowed only if the payment is made within the due date specified by the respective Acts. Finally, bad debts can be claimed as a deduction only if two conditions are satisfied: the debt must have been taken into account in computing income in previous years, and it must be actually written off as irrecoverable in the books of accounts.

6.6.9 Section 37 (1): General (Residuary Deduction)

Section 37(1) acts as the "catch-all" or residuary section for business deductions; if an expense does not fit into the specific categories of Sections 30 to 36, it may still be claimed here provided it meets certain strict conditions. To qualify for deduction under this section, the expenditure must not be in the nature of capital expenditure (like buying a building) or personal expenses of the assessee. Furthermore, it must be laid out or expended wholly and exclusively for the purposes of the business or profession.

However, the law explicitly lists strict disallowances under this section. CSR expenses (Corporate Social Responsibility) are not treated as business expenditure and are thus disallowed (Explanation 2). Similarly, illegal expenses such as protection money, bribes, or fines/penalties for any violation of law are never deductible (Explanation 1). Additionally, expenditure on advertisements in souvenirs or brochures of political parties is disallowed as a business expense, although such amounts may be claimed separately under Chapter VI-A deductions later.

CHECK YOUR PROGRESS

1. Goods and Services Tax and Wealth-tax.
2. Donation to a political party.
3. Cost of installing a new telephone
4. Fees paid to the lawyer for drafting partnership deed.
5. Loss due to embezzlement by an employees.

6.7 PRESUMPTIVE TAXATION

To relieve small taxpayers (business and professionals) from the heavy compliance burden of maintaining detailed books of account and undergoing tax audits. Instead of calculating actual profit (Revenue-Expenses), profit is "presumed" at a fixed percentage of total gross receipts.

1. **Section 44AD: For Small Business**

Target Audience: Small business engaged in trading or manufacturing.

Eligible Taxpayers: Resident Individuals, HUFs and partnership firms. (LLPs and companies are not eligible)

Maximum Turnover Limit: Up to Rs. 2Crore in a financial year. (This limit increase to Rs. 3Crore if cash receipts are 5% or less of total turnover)

Presumed Income Rate: 8% of turnover for cash receipts.

6% of turnover for digital/ banking receipts

2. **Section 44ADA: For Professionals**
3. **Target Audience:** Specified professionals like Doctors, Lawyers, CAs, Architects and Engineers.
4. **Eligible Taxpayers:** Resident Individuals, HUFs and partnership firms. (LLPs and companies are not eligible)
5. **Maximum Turnover Limit:** total gross receipts up to Rs. 50 lakhs in a financial year. (This limit increases to Rs.75 lakhs if cash receipts are 5% or less of total receipts).
6. **Presumed Income Rate:** A flat 50% of turnover of total gross receipts.

3. **Section 44AE: For Transporters**
4. **Target Audience:** Taxpayers engaged in the business of plying, hiring, or leasing goods carriages.
5. **Eligible Taxpayers:** Any taxpayer (Individuals, Firms, Companies etc).
6. **Maximum Turnover Limit:** The taxpayer must not own more than 10 goods vehicles at any time during the financial year.
7. **Presumed Income Rate:** Heavy Vehicles (Gross weight more than 12kg)Rs. 1000 per ton of gross vehicle weight, per month

   Light/ other Vehicles: Rs.7500 per vehicle, per month

CHECK YOUR PROGRESS

6. Gupta & Brothers, a partnership firm, is running a hardware store. The particulars of their income and expenditure for the previous year 2023-24 are as follows:

PARTICULARS	AMOUNT (Rs)
Total receipts from sale of hardware (received entirely through electronic clearing system)	92,00,000
Total expenditure on purchase of materials	61,50,000
Salary and wages paid to workers	16,80,000
Rent of shop and godown	4,20,000

Depreciation	75,000
Interest and Salary to working partners (paid as per sec 40 (b))	3,80,000

Compute the firm's total income u/s 44AD.

7. From the following Profit and Loss Account of Mr. Sharma for the year ending 31st March, compute his taxable income under the head "Profits and Gains of Business or Profession" (PGBP).

Net Profit as per P/L Account: Rs. 5,00,000

Other Information (Adjustments):

- The Profit & Loss account includes a deduction for Income Tax paid amounting to Rs. 30,000.
- Mr. Sharma debited Rs. 20,000 for his personal household expenses to the business account.
- Depreciation charged in the books of accounts is Rs. 50,000.
- Depreciation allowable strictly as per Income Tax Rules is Rs. 65,000.

6.8LET US SUM UP

- In this unit, we have discussed in detail the provisions relating to **Profits and Gains from Business or Profession (PGBP)** under Sections 28 to 44D of the Income-tax Act, 1961. Income arising from any trade, commerce, manufacture, or professional activity is taxable under this head. The distinction between business and profession has also been explained, along with the wide scope of incomes covered under Section 28.
- We have examined the manner of computation of business income as laid down under Section 29, which requires that income be calculated in accordance with Sections 30 to 43D. The process of starting from net profit as per books and making necessary additions and deductions to arrive at taxable business income has been illustrated.
- Further, various statutory deductions under Sections 30 to 37 have been discussed, including rent, repairs, insurance, depreciation, scientific research expenditure, specific business deductions, and general deductions. The concept of depreciation under Section 32, classification of assets, block of assets system, and applicable rates have also been elaborated. Special deductions such as those under Sections 33AB, 35, 35AD, and other relevant provisions were explained to highlight incentives provided for specified industries and research activities.
- The unit also covered the concept of presumptive taxation under Sections 44AD, 44ADA, and 44AE, which simplifies tax compliance for small businesses, professionals, and transporters by prescribing fixed rates of presumed income.

- Overall, this unit provides a comprehensive understanding of the taxation of business and professional income, the method of its computation, allowable deductions, depreciation rules, and simplified taxation schemes, thereby enabling learners to compute taxable income under the head PGBP accurately and systematically.

6.9 ANSWERS TO CHECK YOUR PROGRESS

Answer to Q1: Wealth tax is expressly disallowed. It is levied on the value of assets and so this tax has nothing to do with the carrying on the business. It is tax on wealth and is not payable while earning profit.

The payment of tax on sales (i.e., GST) in the normal running of the business and is made for the purpose of the business. GST in an admissible deduction

Answer to Q2: Donations given to a political party is not allowable business deduction u/s 30-37 but assessee is allowed a deduction for political donations u/s 80 while calculating his total income.

Answer to Q3: Expenses incurred for the purpose of running the business like installation and connection charges of a telephone used for business operations are treated as **business expenditure** and can be deducted when computing profits. According to common tax practice, payments for telephone connection and related charges are allowable deductions under PGBP because they are incurred wholly and exclusively for business purposes.

Answer to Q4: Fees paid to a lawyer for drafting the partnership deed are considered **preliminary or capital expenditure** incurred to set up the business rather than expenses incurred to generate business income during its operation. Therefore, this cost is **not allowed as a deduction** under PGBP when computing taxable business profits.

Answer to Q5: A loss arising from embezzlement or theft by an employee is regarded as a **business loss** that occurred in the normal course of business operations. Such a trading loss is allowed as a deduction when calculating income under PGBP.

Answer to Q6: computation of Total Income under Sec 44AD for the PY 2022-23

PARTICULARS	**AMOUNT (Rs)**
Total Turnover	92,00,000
Estimated income @ 6%of turnover of 92,00,000	5,10,000
Less: Allowable Expenses Remuneration given and allowable u/s 40 (b) to working partners	NIL
Interest on capital and salary given to partners Business Income of the firm	5,10,000
Income from other heads	NIL

Gross total Income & Total Income	**5,10,000**

Answer to Q6: Computation of Income from Business or Profession for Mr. Sharma

Particulars	**Amount (Rs.)**
Net Profit as per Profit & Loss Account	**5,00,000**
Add: Expenses debited but not allowed (Inadmissible Expenses)	
Income Tax paid (Not allowed as a business expense)	30,000
Personal/Household Expenses (Not allowed under Section 37) +1	20,000
Depreciation charged in books (Added back to claim IT depreciation)	50,000
Total Additions	*1,00,000*
Less: Expenses allowed but not debited / Proper Deductions	
Depreciation strictly as per Income Tax Rules	(65,000)
Taxable Income from PGBP	**5,35,000**

Note

 Personal expenses and Income Tax are never allowed as business deductions, so we add them back to the net profit.

 For depreciation, the standard rule is to add back the book depreciation and subtract the depreciation calculated as per Income Tax rules.

6.10 FURTHER READING

- B.K. Singhania & Kapil Singhania (Latest Edition). *Direct Taxes: Law and Practice*. Taxmann Publications.
- Vinod K. Singhania & Kapil Singhania (Latest Edition). *Students' Guide to Income-Tax*. Taxmann Publications.
- T.N. Manoharan & G.R. Hari (Latest Edition). *Manual of Direct Taxes*. Snow White Publications.
- Dinkar Pagare (Latest Edition). *Law and Practice of Income Tax*. Sultan Chand & Sons.
- Institute of Chartered Accountants of India (ICAI). Study Materials and Guidance Notes on Direct Taxes, available at: https://www.icai.org

- Income Tax Department. *Income-tax Act, 1961 and Income-tax Rules, 1962*, available at: https://www.incometaxindia.gov.in

6.11 MODEL QUESTIONS

Q1. Define the terms 'Business' and 'Profession' as per the Income-tax Act. Differentiate between the two with examples.

Q2. List any five types of incomes that are chargeable to tax under the head "Profits and Gains of Business or Profession" (PGBP) under Section 28.

Q3. "Section 29 does not list any deductions or expenses by itself." Discuss this statement and explain the process of computing PGBP income starting from the book profit.

Q5. A company owns a block of Plant & Machinery (Rate 15%).

Opening WDV of the block: Rs. 10,00,000

New machinery acquired and put to use for less than 180 days: Rs. 2,00,000

New machinery acquired and put to use for more than 180 days: Rs. 5,00,000 Calculate the total depreciation allowable for the year using the WDV method

Q6. Evaluate the conditions under which an expenditure can be claimed as a "General Deduction" under Section 37(1). List three specific expenses that are expressly disallowed under this section.

Q7. (Sum) Dr. Sharma, a resident individual, is a professional Doctor. His gross receipts for the previous year were Rs. 45,00,000. He wishes to opt for the presumptive taxation scheme under Section 44ADA. (a) Is he eligible to opt for this scheme? (b) Calculate his presumed income for tax purposes.

UNIT7 : CAPITAL GAINS

UNIT STRUCTURE

7.1 Learning Objectives

7.2 Introduction

7.3 Meaning of Capital Asset

- 7.3.1 Short Term Capital Assest (STCA)
- 7.3.2 Long Term Capital Asset (LTCA)

7.4 Meaning of Transfer of Assets

7.5 Indexed Cost of Acquisition & Indexed Cost of Improvement

7.6 Exemption of Capital Gains

7.7 Capital Gains in Special Cases

- 7.7.1 Slump Sale
- 7.7.2 Bonus Shares
- 7.7.3 Right Shares

7.8 Computation of Capital Gains

7.9 Let Us Sum Up

7.10 Further Reading

7.11 Answers To Check Your Progress

7.12 Model Questions

7.1 LEARNING OBJECTIVES

After studying this unit, you will be able to:

- comprehend the scope of income chargeable under the head “Capital Gains”
- Understand the meaning of 'capital asset' under Section 2(14)
- Distinguish between short-term and long-term capital assets.

- Define 'transfer' under Section 2(47) and identify transactions that are not regarded as transfers.
- Compute the cost of acquisition, cost of improvement, and their indexed equivalents using the Cost Inflation Index.
- Prepare the computation of Short-Term Capital Gains (STCG) and Long-Term Capital Gains (LTCG).
- Explain and compute the exemptions available under Sections 54, 54B, 54EC, 54F.
- Compute Capital Gains in Special Cases :-Slump Sale, Bonus Shares, Right Shares.

7.2 INTRODUCTION

When a person sells or transfers a capital asset — a house, a plot of land, shares, jewellery, or even a business undertaking — and earns a profit on the transaction, that profit is called a 'capital gain'. Capital gains occupy a distinctive place in income tax law: unlike salary or business income, they do not arise from regular activity but from the disposition of assets that one has accumulated over time. They are taxable under the fourth head of income — 'Capital Gains' — governed by Sections 45 to 55A of the Income Tax Act, 1961.

In this unit, we shall begin our discussion with the definition of “capital asset” and “transfer”. Thereafter, we discuss the various circumstances under which capital gains tax is levied. There are certain transactions which are not to be regarded as transfer for the purposes of capital gains. These transactions have also been discussed in this chapter. For computing long-term capital gains, application of cost inflation index is necessary. Again, there is a separate method of computation of capital gains in respect of depreciable assets. Also, there are exemptions in cases where capital gains are invested in specified assets. All these aspects are being discussed in this unit.

7.3 MEANING OF CAPITAL ASSET

Section 45 (1) of the Income Tax Act defines the term ‘‘Capital Gains’’ as profits or gains arising from the transfer of a ‘capital asset’ effected in the previous year are chargeable to tax under the head ‘‘Capital Gains’’. Section 2(14) defines 'capital asset' as property of any kind held by an assessee, whether or not connected with his business or profession. The definition is extraordinarily broad — it includes virtually every form of property. However, the following are specifically EXCLUDED from the definition of capital asset and therefore do NOT attract capital gains tax:

No.	Excluded from Capital Asset Definition	Remarks

1	Stock-in-trade, raw materials, and consumable stores held for business purposes	These are revenue assets — gains on their sale are taxed as business income, not capital gains.
2	Personal effects (movable property) — e.g., furniture, clothing, vehicles, utensils held for personal use	Excludes jewellery, archaeological collections, drawings, paintings, sculptures, and works of art — these ARE capital assets.
3	Agricultural land in India situated in rural areas (i.e., NOT within specified urban limits)	Urban agricultural land IS a capital asset. Rural agricultural land is NOT. Distinction determined by population of municipality and distance from its limits.
4	6.5% Gold Bonds (1977), 7% Gold Bonds (1980), or National Defence Gold Bonds (1980)	These specified government bonds are excluded.
5	Special Bearer Bonds (1991)	Excluded from capital asset definition.
6	Gold Deposit Bonds / Certificates under Gold Deposit Scheme (1999) / Gold Monetisation Scheme (2015)	Excluded — gains on redemption are tax-free.
7	Deposit Certificates issued under Gold Monetisation Scheme, 2015	Fully exempt — interest and redemption proceeds.

7.3.1 SHORT TERM CAPITAL ASSET (STCA)

Section 2(42A) defines short term capital asset as a capital asset held by the assessee for not more than 36 months immediately preceding the date of transfer. The gains arising from the transfer of a short-term capital asset are 'Short-Term Capital Gains' (STCG). The period of holding is counted from the date of acquisition to the date immediately preceding the date of transfer.

7.3.2 LONG TERM CAPITAL ASSET (LTCA)

As per section 2(29A), long-term capital asset means a capital asset which is not a short-term capital asset. Thus, a capital asset held by an assessee for more than 36 months immediately preceding the date of its transfer is a long-term capital asset.

Type of Capital Asset	**Held for MORE THAN (LTCA)**	**Held for UP TO (STCA)**

Listed equity shares, units of equity-oriented mutual funds, units of business trusts	12 months	12 months or less
Listed debentures, Government securities, UTI units (listed), zero-coupon bonds	12 months	12 months or less
Unlisted shares of a company (equity or preference)	24 months	24 months or less
Immovable property (land or building or both)	24 months	24 months or less
All other capital assets (jewellery, gold, paintings, unlisted bonds, etc.)	36 months	36 months or less

However, a security (other than a unit) listed in a recognised stock exchange or a unit of an equity oriented fund, or of UTI or a Zero-Coupon Bond, will be considered as a long-term asset if it is held for period more than 12 months immediately preceding the date of transfer. Further, a share of a company (not being a share which is listed on a recognised stock exchange in India) or an immovable property, being land or building or both would be treated as a short-term capital asset if it was held by an assessee for not more than 24 months immediately preceding the date of its transfer. Thus, the period of holding of unlisted shares or an immovable property, being land or building or both, for being treated as a long-term capital asset would be “more than 24 months” instead of “more than 36 months”.

7.4 MEANING OF TRANSFER OF ASSET

The essential requirement for the incidence of tax on capital gains is the transfer of a “Capital asset”. The Act contains an inclusive definition of 'Transfer' in relation to a capital asset and hence includes:

1. Sale, exchange, or relinquishment of the asset.
2. Extinguishment of any rights therein (e.g., cancellation of a lease).
3. Compulsory acquisition of the asset under any law (e.g., government acquisition for a highway).
4. Conversion of a capital asset into stock-in-trade of a business (treated as a transfer at the market value on the date of conversion).
5. Maturity or redemption of a zero-coupon bond.
6. Allowing possession of an immovable property to be taken in part-performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act (agreement to sell with possession).

7. Any transaction involving allowing of possession, or creation of right in property — to the extent they have the effect of transferring, or enabling enjoyment of, such property.

The following transactions are specifically excluded from the definition of 'transfer' under Section 47 — they do not give rise to capital gains at the time of the transaction:

i. Any distribution of capital assets on the total or partial partition of a HUF [Section 47(i)];

ii. Any transfer of a capital asset under a gift or will or an irrevocable trust [Section 47(iii)];

iii. Any transfer of capital asset by holding company to its wholly owned Indian subsidiary company

iv. Any transfer of capital asset by a subsidiary company to its 100% holding company, being an Indian company

v. Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company [Section 47(vi)].

vi. Any transfer, in a scheme of amalgamation, of shares held in an Indian company by the amalgamating foreign company to the amalgamated foreign company [Section 47(via)].

vii. Any transfer of a capital asset by banking company to banking institution in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949 [Section 47(viaa)].

viii. Any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company referred to in Explanation 5 to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company [Section 47(viab)]

ix. Any transfer in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company [Section 47(vib)].

x. Any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company [Section 47(vic)].

xi. Any transfer in a business reorganisation, of a capital asset by the predecessor co-operative bank to the successor co-operative bank [Section 47(vica)].

xii. Any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank [Section 47(vicb)].

xiii. Any transfer, in a scheme of demerger, of a capital asset, being a share of a foreign company referred to in Explanation 5 to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged

foreign company to the resulting foreign company [Section 47(vicc)].

xiv. Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company, if the transfer or issue is made in consideration of demerger of the undertaking [Section 47(vid)].

xv. Any transfer by a shareholder, in a scheme of amalgamation, of shares held by him in the amalgamating company [Section 47(vii)].

xvi. Any transfer of bonds or Global Depository Receipts referred to in section 115AC(1), by a non-resident to another non-resident outside India [Section 47(viia)].

xvii. Any transfer, made outside India, of a capital asset being rupee denominated bond of an Indian company issued outside India, by a non resident to another non-resident [Section 47(viiaa)].



CHECK YOUR PROGRESS

Q 1: Define the term Capital Gains.

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Q 2: Mention any two transactions which are specifically excluded

7.5 INDEXED COST OF ACQUISITION & INDEXED COST OF IMPROVEMENT

Cost of Acquisition:

The cost of acquisition of a capital asset is the amount actually paid (or deemed to have been paid) to acquire it, including expenses incidental to acquisition such as stamp duty, registration charges, brokerage, and legal fees. Special rules apply in certain cases:

Situation	Cost of Acquisition
Asset acquired by purchase	Actual purchase price + incidental acquisition costs (stamp duty, brokerage, registration).
Asset acquired by inheritance / gift / will / irrevocable trust	Cost to the PREVIOUS OWNER (who originally purchased the asset) — the recipient steps into the shoes of the previous owner.
Asset acquired before 1st April 2001 (Base Year)	Assessee may opt for the higher of: (a) actual cost, or (b) Fair Market Value (FMV) of the asset as on 01.04.2001.

	This is the 'step-up' benefit that eliminates gains accumulated before 2001.
Bonus shares allotted after 01.04.1981	Cost of acquisition = NIL (for computing long-term and short-term gains).
Right shares subscribed by shareholder	Cost = amount actually paid for the right shares.
Right entitlement renounced (sold by shareholder)	Cost of the right entitlement = NIL (nothing was paid to get the entitlement — it arose automatically from shareholding).
ESOP shares acquired under Employee Stock Option Plan	Cost = FMV on the date of exercise of the option (which is also the value taxed as perquisite at the time of exercise).

Cost of Improvement:

Cost of improvement refers to any capital expenditure incurred by an assessee in making any addition or improvement to a capital asset. Key rules:

- Cost of improvement incurred before 01.04.2001 is ignored — only improvement costs after 01.04.2001 are deductible.
- Only CAPITAL expenditure qualifies as cost of improvement — routine maintenance and repairs are revenue expenses and do not qualify.
- For goodwill of a business, tenancy rights, route permits, loom hours, or similar assets, cost of improvement is taken as NIL (since no improvement expenditure is contemplatable for these intangible assets).
- Cost of improvement on inherited/gifted assets: improvements made by the previous owner before 01.04.2001 are ignored; improvements after 01.04.2001 by either the previous owner or the current owner are allowed.

Cost Inflation Index (CII) and Indexation [Section 48]

Indexation is a mechanism to adjust the cost of acquisition and cost of improvement for the effect of inflation, so that the taxpayer is taxed only on real gains (after inflation) rather than on nominal gains. The government notifies a 'Cost Inflation Index' (CII) every year.

The formula for indexed cost is:

Indexed Cost of Acquisition = Cost of Acquisition × CII of Year of Transfer

CII of Year of Acquisition (or Year of Improvement, for indexed cost of improvement)

(For assets acquired before 01.04.2001, the CII of 2001-02 = 100 is used as the denominator)

Important CII values (Base Year 2001-02 = 100):

FY	CII	FY	CII	FY	CII
2001-02	100	2012-13	200	2019-20	289
2004-05	113	2014-15	240	2020-21	301
2006-07	122	2015-16	254	2021-22	317
2008-09	137	2016-17	264	2022-23	331
2010-11	167	2017-18	272	2023-24	348
2011-12	184	2018-19	280	2024-25	363

The Finance Act, 2024 made significant changes to indexation: For immovable property sold on or after 23.07.2024, taxpayers can choose between (a) LTCG at 12.5% without indexation, or (b) LTCG at 20% with indexation (if purchased before 23.07.2024). For assets other than property, indexation continues to apply as before.



CHECK YOUR PROGRESS

Q 3: What do you mean by Cost Inflation Index?

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7.6 EXEMPTION OF CAPITAL GAINS

The Income Tax Act provides several exemptions from capital gains primarily to encourage reinvestment of gains into productive assets such as residential housing, agricultural land, bonds, or start-ups. These exemptions reduce or eliminate the capital gains tax liability if the prescribed reinvestment is made within the specified time limits. Below is a comprehensive treatment of each exemption.

1. **Capital Gains on sale of residential house [Section 54]**
   Eligible assessees – Individual & HUF
   Conditions to be fulfilled

• There should be a transfer of residential house (buildings or lands appurtenant thereto)
• It must be a long-term capital asset
• Income from such house should be chargeable under the head “Income from house property”

Quantum of Exemption

• If cost of new residential house or houses, as the case may be ≥ Long term capital gains, entire long term capital gains is exempt.

• If cost of new residential house or houses, as the case may be < Long term capital gains, long term capital gains to the extent of cost of new residential house is exempt.

2. **Capital Gains on transfer of agricultural land [Section 54B]**
Eligible assessee – Individual & HUF
Conditions to be fulfilled
• There should be a transfer of urban agricultural land.
• Such land must have been used for agricultural purposes by the assessee, being an individual or his parent, or a HUF in the 2 years immediately preceding the date of transfer.
• He should purchase another agricultural land (urban or rural) within 2 years from the date of transfer.
• If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS. Amount utilized by the assessee for purchase of new asset and the amount so deposited shall be deemed to be the cost of new asset.
Quantum of exemption
• If cost of new agricultural land ≥ capital gains, entire capital gains is exempt.
• If cost of new agricultural land < capital gains, capital gains to the extent of cost of new agricultural land is exempt.

3. **Capital Gains not chargeable on investment in certain bonds [Section 54EC]**
Eligible assessee – Any assessee
Conditions to be fulfilled
• There should be transfer of a long-term capital asset being land or building or both.
• Such asset can also be a depreciable asset held for more than 36 months.
• The capital gains arising from such transfer should be invested in a long-term specified asset within 6 months from the date of transfer.
• Long-term specified asset means specified bonds, redeemable after 5 years, issued on or after 1.4.2018 by the National Highways Authority of India (NHAI) or the Rural Electrification Corporation Limited (RECL) or any other bond notified by the Central Government in this behalf.
• The assessee should not transfer or convert or avail loan or advance on the security of such bonds for a period of 5 years from the date of acquisition of such bonds.
Quantum of exemption

Capital gains or amount invested in specified bonds, whichever is lower.

4. **Capital gains in cases of investment in residential house [Section 54F]**

Eligible assessees: Individuals/ HUF

Conditions to be fulfilled

• There must be transfer of a long-term capital asset, not being a residential house.

• Transfer of plot of land is also eligible for exemption

• The assessee should –

♦ Purchase one residential house situated in India within a period of 1 year before or 2 years after the date of transfer; or

♦ Construct one residential house in India within 3 years from the date of transfer.

• If such investment is not made before the date of filing of return of income, then the net sale consideration has to be deposited under the CGAS. Amount utilized by the assessee for purchase or construction of new asset and the amount so deposited shall deemed to be the cost of new asset.

• The assessee should not own more than one residential house on the date of transfer.

• The assessee should not –

♦ purchase any other residential house within a period of 2 year or

♦ construct any other residential house within a period of 3 years from the date of transfer of the original asset.

Quantum of exemption

• If cost of new residential house ≥ Net sale consideration of original asset, entire capital gains is exempt.

• If cost of new residential house < Net sale consideration of original asset, only proportionate capital gains is exempt i.e.

$$\text{LTCG} \times \frac{\text{Amount invested in new residential house}}{\text{Net sale consideration}}$$

Under sections 54, 54B and 54F capital gain is exempt to the extent of investment of such gains/ net consideration (in the case of section 54F) in specified assets within the specified time. If such investment is not made before the date of filing of return of income, then the capital gain or net consideration (in case of exemption under section 54F) has to be deposited under the Capital Gains Account Scheme (CGAS). Such deposit in CGAS should be made before filing the return of income or on or before the due date of filing the return of income, whichever is earlier.



CHECK YOUR PROGRESS

Q 4: State the conditions to be fulfilled for availing exemption on Capital Gains on sale of residential house [Section 54]?

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7.7 CAPITAL GAINS IN SPECIAL CASES

7.7.1 Slump Sale

A 'slump sale' is the transfer of one or more undertakings (a division or business unit) for a lump sum consideration, without assigning values to the individual assets and liabilities. The entire business is sold as a going concern for a single price. Section 50B provides the specific computation rules for such transactions:

- The gain from a slump sale is always treated as long term if the undertaking has been owned for more than 36 months. If owned for 36 months or less, it is short term.
- Net Worth of the Undertaking = Aggregate value of total assets (book value) minus value of liabilities of the undertaking.
- Capital Gains = Sale Consideration minus Net Worth of the Undertaking.
- Indexation benefit is NOT available for slump sale — the computation uses the actual net worth, not an indexed figure.

7.7.2 Bonus Shares

Bonus shares are additional shares issued by a company to its existing shareholders free of cost, out of its accumulated reserves. The tax treatment of bonus shares has two components:

When Bonus Shares are Received

- No capital gains arise when bonus shares are received — receiving bonus shares is not a 'transfer' by the shareholder.
- The cost of acquisition of the bonus shares is taken as nil (since nothing was paid for them).
- The date of acquisition of bonus shares is the date on which they are allotted — not the date of acquisition of the original shares.

When Bonus Shares are Subsequently Sold

- STCG or LTCG depends on the period for which the Bonus shares (not the original shares) were held.
- For listed equity bonus shares: if held > 12 months = LTCA; if held ≤ 12 months = STCA.
- LTCG on sale of bonus shares: Sale price minus NIL (cost) = entire sale price is LTCG.

7.7.3 Right Shares

When a company issues rights shares, existing shareholders have the 'right' to subscribe to additional shares at a price (usually below market price). There are two scenarios:

Scenario A: Shareholder Subscribes to Right Shares

- Cost of acquisition of right shares = Amount actually paid to subscribe.
- Date of acquisition = Date of allotment of right shares.
- Period of holding calculated from the date of allotment of right shares.

Scenario B: Shareholder Renounces (Sells) the Right Entitlement

- The 'right entitlement' (the right to subscribe) is itself a capital asset.
- Cost of acquisition of the right entitlement = NIL (the shareholder received it free of cost by virtue of holding the original shares).
- STCG or LTCG on sale of right entitlement = Entire amount received, since cost = NIL.

Period of holding: From the date of offer of rights to the date of renunciation.

7.8 COMPUTATION OF CAPITAL GAINS

Section 48 of the Act provides that the income chargeable under the head 'capital gains' shall be computed by deducting the following items from the full value of the consideration received or accruing as a result of the transfer of the capital asset:

(i) Expenditure incurred wholly and exclusively in connection with such transfer.

(ii) The cost of acquisition and cost of any improvement thereto.

However, no deduction shall be allowed in computing the income chargeable under the head "Capital Gains" in respect of any amount paid on account of securities transaction tax under Chapter VII of the Finance (No.2) Act, 2004.

Under section 48, for computation of long term capital gains, the cost of acquisition and cost of improvement increased by applying the cost inflation index (CII). Once the cost inflation index is applied to the cost of acquisition and cost of improvement, it becomes indexed cost of acquisition and indexed cost of improvement.

Short-Term Capital Gains (STCG)

Particulars	**Amount (Rs.)**
Full Value of Consideration (Sale price or Fair Market Value, whichever is applicable)	xxx
Less: Expenditure incurred wholly and exclusively in connection with transfer (brokerage, legal fees, transfer charges, etc.)	(xxx)
Net Consideration	xxx
Less: Cost of Acquisition	(xxx)
Less: Cost of Improvement (if any)	(xxx)

SHORT-TERM CAPITAL GAINS (STCG)	**XXX**

Long-Term Capital Gains (LTCG)

Particulars	**Amount (Rs.)**
Full Value of Consideration (Sale price or deemed sale price)	xxx
Less: Expenditure incurred wholly and exclusively in connection with transfer	(xxx)
Net Consideration	xxx
Less: Indexed Cost of Acquisition (Cost × CII of Transfer Year / CII of Acquisition Year)	(xxx)
Less: Indexed Cost of Improvement (if any) (Cost of Improvement × CII Transfer / CII Year of Improvement)	(xxx)
Less: Exemptions under Sections 54, 54B, 54D, 54EC, 54F, 54G, 54GA, 54GB (as applicable)	(xxx)
LONG-TERM CAPITAL GAINS (LTCG) — Chargeable to Tax	**XXX**

The 'Full Value of Consideration' for immovable property is subject to the provisions of Section 50C: if the actual sale price is lower than the stamp duty value (circle rate) of the property, the stamp duty value is taken as the full value of consideration, unless the difference is within 10% of the actual sale price.

Tax Rates on Capital Gains

Type of Asset & Gain	**Tax Rate (Old — pre-23.07.2024)**	**Tax Rate (New — post-23.07.2024)**	**Section**
STCG — Listed equity / equity MF (STT paid)	15%	20%	111A
STCG — All other assets	Slab rates	Slab rates	General

LTCG — Listed equity / equity MF (STT paid) — exceeding Rs. 1 lakh	10% (without indexation)	12.5% (without indexation; threshold Rs. 1.25 lakh)	112A
LTCG — Immovable property (land/building)	20% with indexation	12.5% without indexation OR 20% with indexation (for purchases before 23.07.2024)	112
LTCG — Unlisted shares, gold, jewellery, other assets	20% with indexation	12.5% without indexation	112
LTCG — Bonds, debentures (listed/unlisted)	10% without indexation	12.5% without indexation	112

Surcharge on LTCG under Section 112A (listed equity / equity MF) is capped at 15%, regardless of the total income of the taxpayer. This prevents the effective tax rate from exceeding approximately 14.25% + 4% cess = approximately 14.82%. For other LTCG, normal surcharge rates apply.

7.9 LET US SUM UP

In this unit we have discussed the following:

- Capital gains arise only on 'transfer' of a 'capital asset'. Both terms are defined broadly but with specific exclusions — understanding what falls outside the definitions is as important as understanding what is included.
- Assets are classified as Short-Term (STCA) or Long-Term (LTCA) based on holding period thresholds that differ by asset class: 12 months for listed equity/equity MFs, 24 months for immovable property/unlisted shares, and 36 months for all other assets.
- Certain transactions — gifts, inheritances, holding company-subsidiary transfers, amalgamations — are not regarded as 'transfers' and do not trigger capital gains tax at the time of the transaction.
- Indexation adjusts the cost of acquisition/improvement for inflation using the Cost Inflation Index (base year 2001-02 = 100). It is available only for LTCA and not for listed equity, bonds, or slump sales. Post-Finance Act 2024, taxpayers selling immovable

property may choose between 12.5% LTCG without indexation or 20% LTCG with indexation.

- STCG on listed equity (STT paid) is taxed at 20% (post-23.07.2024) under Section 111A. LTCG on listed equity exceeding Rs. 1.25 lakh is taxed at 12.5% under Section 112A. All other LTCG is taxed at 12.5% or 20% with indexation.
- Slump sale gains are always computed using Net Worth (not indexed cost) and are LTCG/STCG based on the undertaking's holding period — no indexation.
- Bonus shares: cost = NIL; holding from allotment date. Right shares: cost = amount paid; right entitlement cost = NIL.

7.10 FURTHER READING

- Singhania, V.K. & Singhania, M. — Students' Guide to Income Tax (Taxmann Publications) — Latest Edition
- Ahuja, G.K. & Gupta, R. — Systematic Approach to Income Tax (Bharat Law House) — Latest Edition
- Kanga, Palkhivala & Vyas — The Law and Practice of Income Tax (LexisNexis) — Latest Edition
- Income Tax Act, 1961 — Sections 2(14), 2(47), 45, 47, 48, 49, 50, 50B, 54, 54B, 54D, 54EC, 54F, 54G, 54GA, 54GB, 55, 112, 112A — Bare Act
- CBDT Notification on Cost Inflation Index — notified annually (check www.incometaxindia.gov.in)
- Finance Act, 2024 — Capital gains amendments effective 23.07.2024: www.indiabudget.gov.in
- SEBI and NSE/BSE investor education resources for understanding capital gains on equity investments

7.11 ANSWERS TO CHECK YOUR PROGRESS

Answer to Q 1:

Section 45 (1) of the Income Tax Act defines the term ‘‘Capital Gains’’ as profits or gains arising from the transfer of a ‘capital asset’ effected in the previous year are chargeable to tax under the head ‘‘Capital Gains’’

Answer to Q 2:

Two transactions which are specifically excluded from the definition of 'transfer' under Section 47.

1. Sale, exchange, or relinquishment of the asset.
2. Extinguishment of any rights therein (e.g., cancellation of a lease).

Answer to Q 3: Cost Inflation Index is a mechanism to adjust the cost of acquisition and cost of improvement for the effect of inflation, so that the taxpayer is taxed only on real gains (after inflation) rather than on nominal gains. The government notifies a 'Cost Inflation Index' (CII) every year.

Answer to Q No. 4 Conditions to be fulfilled for availing exemption on Capital Gains on sale of residential house u/s Section 54 are as follows:

- There should be a transfer of residential house (buildings or lands appurtenant thereto)
- It must be a long-term capital asset
- Income from such house should be chargeable under the head “Income from house property”

7.12 MODEL QUESTIONS

Short Answer Questions

1. What is a capital asset? Distinguish between a short-term and a long-term capital asset.
2. Define 'transfer' under Section 2(47). Name any four transactions that are not regarded as transfers.
3. What is the Cost Inflation Index? How is indexed cost of acquisition computed? Give an example.
4. Explain the concept of 'slump sale' and how capital gains are computed under Section 50B.

Long Answer Questions

5. Discuss the computation of Long-Term Capital Gains on the sale of a residential house property, including the provisions relating to cost of acquisition (with base year 2001-02 option), indexation, and the exemptions available.

6. Compare and contrast the exemptions available under Sections 54, 54B, 54EC, and 54F, with reference to eligible assets, eligible reinvestment, time limits, lock-in periods, and maximum exemption available.
7. Explain the tax treatment of: (a) bonus shares, and (b) right shares.
8. Write a comprehensive note on the changes brought about by the Finance Act, 2024 to the capital gains tax regime in India, including changes to tax rates, holding period thresholds, and indexation.

Practical / Numerical Questions

9. Mr. Animesh purchased a residential flat in Guwahati on 01.07.2005 for Rs. 18,00,000 (CII 2005-06 = 117). He spent Rs. 3,00,000 on renovation in FY 2015-16 (CII 2015-16 = 254). He sold the flat on 15.11.2025 for Rs. 1,20,00,000 (CII 2023-24 = 348). He purchased a new flat for Rs. 55,00,000 on 10.02.2026. Compute his taxable LTCG after exemption under Section 54. (Assume FMV on 01.04.2001 = Rs. 22,00,000.)
10. Ms. Kanaklata holds 2,000 equity shares of XYZ Ltd. purchased on 01.04.2020 at Rs. 300 per share. On 01.08.2021, the company issues 1:1 bonus shares. She sells all 4,000 shares on 01.11.2025 at Rs. 600 per share (STT paid, listed on NSE). Compute her capital gains and tax thereon for AY 2026-27 (CII not applicable for listed equity).
11. Mr. Kopil Borah sold the following assets during FY 2025-26: (a) Listed shares (held 8 months): STCG Rs. 2,80,000. (b) Gold (held 5 years): LTCG Rs. 1,50,000. (c) Residential plot (held 3 years): LTCG Rs. 6,20,000. Compute the net taxable capital gains.

UNIT 8: INCOME FROM OTHER SOURCES

UNIT STRUCTURE

8.1 Learning Objectives
8.2 Introduction
8.3 Meaning and Scope of Income from Other Sources
8.4 Incomes Specifically Chargeable under this Head
8.5 Incomes Not Included under this Head
8.6 Deductions under Section 57
8.7 Amounts Not Deductible under Section 58
8.8 Computation of Income from Other Sources
8.9 Let Us Sum Up
8.10 Further Reading
8.11 Answers to Check Your Progress
8.12 Model Questions

8.1 LEARNING OBJECTIVES

After studying this unit, you will be able to:

- understand the residual nature of income taxable under this head
- identify incomes chargeable under “Income from Other Sources”
- distinguish between incomes taxable under this head and other heads
- explain deductions allowable under Section 57
- identify inadmissible expenses under Section 58
- compute taxable income under this head

8.2 INTRODUCTION

The Income Tax Act classifies income under five heads. However, not all receipts neatly fall within the heads such as salary, house property, business, or capital gains. To ensure that no taxable income escapes taxation, a residuary head called **“Income from Other Sources”** has been provided.

This head acts as a **catch-all category**, covering incomes that are not specifically taxable under any other head. It is governed primarily by Sections 56 to 59 of the Income Tax Act, 1961.

In this unit, we examine the scope, types of incomes covered, permissible deductions, and the method of computation under this head.

8.3 MEANING AND SCOPE OF INCOME FROM OTHER SOURCES

“Income from Other Sources” is regarded as the fifth and residuary head of income. It covers all incomes that do not clearly fall within the scope of the first four heads, along with certain

specified categories of income. Section 56 is broadly worded and is intended to include every type of receipt that qualifies as income, making it taxable under the Act unless it is specifically exempt."

The Act divides these earnings into two distinct groups under Section 56:

General Incomes (Section 56(1)): This includes any revenue that meets the broad criteria for "income" but lacks a specific classification in other sections.

Specified Incomes (Section 56(2)): This includes a list of particular types of income such as dividends, lottery winnings, or interest on securities that the law explicitly mandates be taxed under this head.

Section 56(1) provides that income of every kind which is not to be excluded from total income and not chargeable under any other head shall be chargeable under the head **"Income from Other Sources."**

Thus, this head has the following characteristics:

- It is **residuary in nature**
- Applies only when income is **not covered elsewhere**
- Covers both **recurring and non-recurring incomes**

8.3.1 INCOMES SPECIFICALLY CHARGEABLE U/S 56 (1)

The following incomes are expressly taxable under this head:

1. Income derived by a coal mine owner from rent and royalties are included in this head.
2. Income earned by an assessee from licenses granted to brick-makers, to erect brickkilns upon his land and to take away the brick-earth and use it for making bricks.
3. Remuneration received merely for being a director and not as employees, is not salary but income from other sources.
4. Income received by an assessee from a person other than his employer. E.g. university remuneration.
5. Interest on loans, securities, deposits and current accounts also come under this head.
6. Income received by a professional man as a university examiner.
7. Income received on sub-letting of the house.
8. Tips received by a waiter or taxi driver, not being given by his employer.
9. Family pension received by legal heirs of employees.
10. Income from undisclosed sources (i.e., deemed incomes covered under sections 68, 69, 69A, 69B, 69C, 69D.

8.3.2 INCOMES SPECIFICALLY CHARGEABLE U/S 56 (2)

Under section 56(2), in particular, the following incomes shall be chargeable to income-tax under the head "Income from Other Sources":

1. Dividends. [Section 56(2)(i)]

2. Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever. These can be called as casual incomes. [Section 56(2) (ib)]

3. Any sum received by assessee from his employees as contribution to any provident fund or superannuation fund or any fund set up under the provisions of Employees State Insurance Act, 1948 or any other fund for the welfare of such employees (Section 2 (24) (X) if such income is not chargeable to tax under the head “PGBP” Section 56 (2) (ic).

4. Any income by way of interest on securities if the income is not chargeable to tax under the head “PGBP” {Section 56 (2) (id)}.

5. Rental income from machinery, plant and furniture belonging to the assessee and let on hire, if the income is not chargeable to income-tax under the head "Profits and Gains of Business or Profession". [Section 56(2)(ii)]

6. Rental income if an assessee lets on hire, machinery, plant or furniture belonging to him and also building and the letting of the building is inseparable from the letting of the said machinery, plant or furniture, the income from such letting if it is not chargeable to income-tax under the head "Profits and Gains of Business or Profession." [Section 56(2)(iii)]

7. Any sum received under a keyman insurance policy including bonus if such a sum is not taxable as salary or business income. [Section 56(2)(iv)]

8. Any consideration received by a closely held company for issue of shares that exceeds the face value of such shares. [Section 56(2)(viib)]

9. Income by way of interest received on compensation or on enhanced compensation.

10. Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset and forfeited due to non transfer of such capital asset.[Section56(2)(ix)]

11. Gifts received by any person on or after 1-04-2017 shall be treated as income from other source as discussed below: [Section 56(2)(x)]

(a) Any sum of money received by any person from any person or persons without consideration exceeding 50,000 in aggregate during a previous year. The whole of such amount shall be chargeable to tax under the head 'Income from Other Sources.'

(b) (i)Any immovable property received by any person from any person without consideration ing 50.000, the stamp duty value of such property shall be taxable under the head “Income from Other Sources”.

(ii) Any immovable property received by any person for a consideration which is less than the stamp duty value of such property by an amount exceeding ₹ 50,000, the stamp duty value of such property as exceeds such consideration, shall be taxable under the head 'Income from Other Sources'. Where the date of agreement and the date of registeration are not the same, the stamp duty value on the date of agreement shall be considered.

(c) (i) Any property other than immovable property received by any person from any person without consideration, the aggregate F.M.V. of which exceeds ₹50,000, the whole of the aggregate F.M.V. of such property shall be taxable under the head 'Income from Other Sources'.

(ii) Any property other than immovable property received by any person from any person for a consideration which is less than the aggregate F.M.V. of the property by an amount exceeding₹50,000, the excess of aggregate F.M.V. of such property/properties over such consideration shall be taxable under the head 'Income from Other Sources'.

12.Any compensation or other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto. [Section 56(2)(xi)].

13. Any specified sum received by a unit holder from a business trust during the previous year, with respect to a unit held by him at any time during the previous year. [Section 56(2)(xii)][w.e.f. A.Y. 2024-25]

14. Where any sum is received, including the amount allocated by way of bonus, at any time during a previous year, under a life insurance policy, other than the sum-

(a) Received under a unit linked insurance policy;

(b) Being the income referred to in clause (iv) i.e. any sum received under a keyman insurance policy;

Which is not to be excluded from the total income of the previous year in accordance with the provisions of section 10(10D), the sum so received as exceeds the aggregate of the premium paid, during the term of such life insurance policy, and not claimed as deduction under any other provision of this Act, computed such manner as may be prescribed. [Section 56(2)(xiii)]

CHECK YOUR PROGRESS

Q1: What is meant by “Income from Other Sources”?
.....

Q2: Name any two incomes taxable under this head.
.....

8.5 INCOMES NOT INCLUDED UNDER THIS HEAD

Certain incomes are excluded because they are taxable under other heads:

- Salary → taxed under “Income from Salary”
- Rental income from house property → taxed under “House Property”
- Business income → taxed under “Profits and Gains of Business or Profession”
- Capital gains → taxed under “Capital Gains”

8.6 DEDUCTIONS UNDER SECTION 57

Section 57 of the Income Tax Act provides for certain deductions that can be claimed while computing income under the head “Income from Other Sources.” These deductions are allowed to ensure that only the net income, after considering relevant expenses, is subjected to tax. The following are the main deductions permitted under this section:

1. **Commission or Remuneration**
   Any reasonable amount paid as commission or remuneration to a person for the purpose of collecting or realizing income, such as dividends or interest, is allowed as a deduction. This expense must be directly related to earning such income.
2. **Repairs and Insurance (in case of plant, machinery, or furniture)**
   Expenses incurred on the repair, maintenance, and insurance of plant, machinery, or furniture are deductible, provided these assets are used for generating income taxable under this head.
3. **Standard Deduction for Family Pension**
   In the case of family pension received by a legal heir, a standard deduction is allowed. The amount of deduction shall be the lower of:

- ₹15,000, or
- One-third (1/3rd) of the total family pension received during the year.

   This provision ensures partial relief to the recipient of family pension.

4. **Any Other Expenditure**
   Any other expenditure is also allowed as a deduction, provided it is incurred wholly and

exclusively for the purpose of earning such income. The expense must have a clear and direct connection with the income earned and should not be personal or capital in nature.

In summary, Section 57 permits taxpayers to deduct legitimate expenses that are closely linked to the earning of income under this category, thereby ensuring that taxation is levied only on the actual income after necessary expenses have been accounted for.

CHECK YOUR PROGRESS

Q3: State any two deductions allowed under Section 57.
.....

8.7 AMOUNTS NOT DEDUCTIBLE UNDER SECTION 58

The following are not allowed:

1. Personal expenses
2. Interest payable outside India without TDS compliance
3. Salary payable outside India without TDS
4. Expenses not incurred wholly for earning income

8.8 COMPUTATION OF INCOME FROM OTHER SOURCES

The computation is done as follows:

Particulars	**Amount (₹)**
Gross Income	XXX
Less: Deductions under Section 57	(XXX)
Income from Other Sources	**XXX**

Special Cases:

- **Lottery income** → taxed at flat rate (no deduction allowed)
- **Gift income** → taxable if exceeding threshold

8.9 LET US SUM UP

In this unit, we have discussed:

- "Income from Other Sources" acts as a **residual head of income**
- It includes incomes like dividends, interest, winnings, gifts, etc.
- Deductions are allowed under Section 57 but restricted
- Certain expenses are disallowed under Section 58

- Proper classification is essential before computation

SUMMARY CHART – INCOME FROM OTHER SOURCES

Incomes u/s 56(1)	Incomes u/s 56(2)	Expenses u/s 57	Exempted Incomes	No TDS
1. Agricultural income earned outside India	1. Dividend from Indian/foreign companies, co-operative societies and deemed dividend	A. No deduction allowed from casual incomes such as lotteries, races, puzzles, etc.	1. Interest on certain notified securities	1. Bank interest on FD/RD up to ₹40,000 (₹50,000 for senior citizens)
2. Receipts from persons other than employer	2. Interest on securities	B. Bank commission and collection charges (other than dividend income)		2. Race winnings up to ₹10,000
3. Income from sub-letting or rent of vacant land	3. Winnings from lotteries, races, crossword puzzles, TV game shows, card games, gambling, betting	C. Interest on loan taken to acquire income-generating asset		3. Lottery/puzzle winnings up to ₹10,000
4. Director's fees or sitting fees	4. Gifts received (not exempt under section 56(2)(x))	D. Standard deduction for family pension: lower of ₹15,000 or 1/3rd of pension		4. Card games or similar winnings up to ₹10,000
5. Remuneration from lectures or article writing	5. Income from letting of plant and machinery (not business income)	E. Repairs, insurance, local taxes, and depreciation on assets		5. Dividend up to ₹5,000
6. Withdrawal from NSS (principal + interest)	6. Composite rent from letting building with furniture/plant where inseparable	F. Employer's contribution to PF/ESI deposited within due date		6. Interest paid by certain companies to individuals/HUF up to ₹5,000
7. Repurchase	7. Employees' contribution to	G. Any other		

Incomes u/s 56(1)	Incomes u/s 56(2)	Expenses u/s 57	Exempted Incomes	No TDS
of units under section 80CCB	PF/ESI collected by employer	expenditure incurred wholly and exclusively for earning such income		
8. Casual incomes (not covered under section 56(2))	8. Excess share premium received by closely held companies	H. Interest on borrowed funds for shares (max 20% of dividend income)		
9. Interest income (not covered under section 56(2))	9. Interest on compensation/enhanced compensation			
	10. Forfeited advance money on failed transfer of capital asset			
	11. Compensation on termination/modification of contract			
	12. Amount received from business trust by unit holders			
	13. Non-exempt sums from life insurance policies			

8.10 FURTHER READING

1. Singhania, V.K. – *Students' Guide to Income Tax*
2. Ahuja & Gupta – *Systematic Approach to Income Tax*
3. Income Tax Act, 1961 – Sections 56 to 59
4. Latest Finance Act

8.11 ANSWERS TO CHECK YOUR PROGRESS

Answer 1:
Income from Other Sources refers to income which is not chargeable under any other head and is taxable under Section 56.

Answer 2:
(i) Dividend income
(ii) Lottery winnings

Answer 3:
(i) Commission for earning income
(ii) Standard deduction on family pension

8.12 MODEL QUESTIONS

Short Answer Questions

1. Define “Income from Other Sources.”
2. List any four incomes taxable under this head.
3. What are the deductions allowed under Section 57?
4. Explain the taxability of gifts under Section 56(2)(x).

5. Explain the scope and significance of “Income from Other Sources” as a residuary head.
6. Discuss the deductions allowed and disallowed under Sections 57 and 58.
7. Explain the tax treatment of dividend income and lottery winnings.
8. Discuss the provisions relating to taxation of gifts in detail.

9. Mr. A received ₹80,000 as gift from a friend and ₹20,000 from his father. Compute taxable income.
10. Mrs. B received family pension of ₹60,000. Calculate taxable amount after deductions.
11. Mr. C earned ₹1,00,000 as lottery income and incurred ₹10,000 as expenses. Compute taxable income.

Unit 9: Clubbing of Income and Set-off and Carry Forward of Losses

UNIT STRUCTURE

1.1 Learning Objectives

1.2 Meaning of Clubbing of Income

1.3 Overview of Provisions Relating to Clubbing of Income

1.4 Set-off and Carry Forward of Losses

1.5 Let's Sum Up

1.6 Multiple Choice Questions

1.7 Further Reading

1.8 Very Short Answer Type Questions

1.9 Short Answer Type Questions

1.0 Essay Type Questions

1.1 Practical Problems

1.1 Learning Objectives

After going through this unit, you will be able to:

1. Understand the meaning and purpose of clubbing provisions under the Income-tax Act, 1961.
2. Identify situations where income of another person is included in the assessee's total income.
3. Apply provisions relating to spouse, minor child and transfer of assets.
4. Compute taxable income after applying clubbing rules.
5. Understand intra-head and inter-head set-off of losses.
6. Explain rules for carry forward of different types of losses.
7. Identify time limits and conditions for set-off.
8. Compute total income after adjusting current and brought forward losses.

(CLUBBING OF INCOME) (Section 60-64)

1.2 Meaning of Clubbing of Income

Clubbing of income refers to the inclusion of income of another person in the total income of the assessee for the purpose of taxation.

Generally, an assessee is taxed on his or her own income. However, in certain exceptional circumstances, this basic principle is departed from, and an assessee may be taxed on income that legally belongs to another person. In the past, taxpayers attempted to reduce their tax liability by transferring assets to family members or by structuring their sources of income in a manner that shifted the tax burden to others while retaining the benefits of such income. To prevent such tax avoidance practices, specific provisions have been incorporated under Sections 60 to 64 of the Income Tax Act

Clubbing of income means adding the income of another person, such as a spouse or minor child, to the taxpayer's total income under Sections 60–64 of the Income Tax Act, 1961, to prevent tax evasion by discouraging the transfer of income to family members in lower tax brackets.

Income tax in India is levied on an individual's total income according to a slab rate system, where higher income attracts higher tax rates. Currently, tax rates range from 5% to a maximum of 30%. To reduce their tax liability, taxpayers often try to divert a portion of their income to relatives or family members who fall into lower tax brackets or have income below the taxable limit.

To prevent such tax avoidance practices, the Income Tax Act, 1961 has introduced specific provisions under Sections 60 to 65. These provisions ensure that income transferred to another person under certain circumstances is included, or "clubbed," in the income of the original taxpayer. Such income is known as deemed income or clubbed income, and the main objective of these provisions is to curb tax evasion.

The Income-tax Act, 1961 specifies certain situations where income earned by one person is required to be included in the income of another person, provided specific conditions are satisfied. This statutory inclusion of income is known as *Clubbing of Income*.

Example: If a husband transfers a part of his income to his wife with the intention of reducing his tax liability, such transferred income shall be included in the income of the husband and taxed in his hands, not in the hands of the wife.

1.3 Overview of Provisions Relating to Clubbing of Income

A. Transfer of income without transfer of assets [Section 60]

B. Revocable transfer of assets [Section 61]

C. Remuneration received by spouse [Section 64(1) (ii)]

D. Income from assets transferred to spouse [Section 64(1) (iv)]

E. Income from assets transferred to son's wife [Section 64(1) (vi)]

F. Income from assets transferred to a person for the benefit of spouse [Section 64(1) (vii)]

G. Income from assets transferred to a person for the benefit of son's wife [Section 64(1) (viii)]

H. Income of minor child [Section 64(1A)]

I. Transfer of asset to Hindu Undivided Family [Section6 64(2)]

A. Transfer of Income without Transfer of Assets [Section 60]

Section 60 applies when the following conditions are fulfilled:

- The taxpayer owns an asset.
- The ownership of the asset is not transferred.
- The income from the asset is transferred to another person under an settlement, trust, an agreement or arrangement.
- The above transfer maybe revocable or may irrevocable.

If these conditions are satisfied, the income from the asset shall be taxable in the hands of the transferor.

Example: Mr. Kumar transfers the right to receive rent from his house property to his friend Mr.Verma without transferring ownership of the house. In this case, the rent received by Mr. Verma shall be clubbed with the income of Mr. Kumar.

B. Revocable Transfer of Assets [Section 61]

A revocable transfer means a transfer where the transferor retains the right to reassume ownership of the asset or income from the asset, either wholly or partly, at any time during the lifetime of the transferee.

Section 61 becomes applicable if:

- An asset is transferred under a revocable transfer.
- The transfer is made through an agreement or settlement.

In such cases, the income arising from the transferred asset shall be taxable in the hands of the transferor.

Exceptions to Section 61

Where an asset is transferred under a revocable transfer, the income arising from such asset shall be taxable in the hands of the transferor. For this purpose, the term transfer includes any settlement, trust, agreement, or arrangement.

A transfer shall be regarded as a revocable transfer in any of the following cases:

Where the transfer of the asset is revocable during the lifetime of the transferee or beneficiary.

Where the transfer contains any provision for the re-transfer of the asset or the income arising therefrom to the transferor, either directly or indirectly, wholly or partly.

Where the transferor retains any right to reassume power over the asset or the income arising therefrom, either directly or indirectly, wholly or partly.

Section 61 shall not apply in the following cases:

- Transfer by way of trust which is not revocable during the lifetime of the beneficiary.
- Any other transfer which is not revocable during the lifetime of the transferee.
- Transfer made before 01.04.1961, which is not revocable for a period of six years or more.

Example:
1. A transfer a house property to X. However, A has a right to revoke the transfer during the lifetime of X. it is a revocable transfer and income arising from the house property is taxable in the hands of A.
2. A transfer an asset on March 31, 1961. It is revocable on or before June 6, 1963. It is a revocable transfer. Income arising from the asset is taxable in the hands of A. conversely, if A transfers an asset before April 1, 1961 and it is revocable after 6 years (say, on April 10, 1967), it is not taken as a revocable transfer.

C. Any salary, commission, fee or any other remuneration received by Spouse from a concern in which other spouse has substantial interest [Section 64(1) (ii)]

The income of an individual shall include the remuneration earned by the spouse from a concern in which the individual has a substantial interest, as provided under Section 64(1) (ii) of the Income Tax Act, 1961.

Section 64(1) (ii) is applicable when the following conditions are fulfilled:

1. The taxpayer is an individual.
2. The taxpayer has a substantial interest in a concern. The concern may be any form of business or professional entity, such as a sole proprietorship, partnership, or company.
3. The spouse of the taxpayer is employed in the said concern.
4. The spouse is employed without possessing any technical or professional qualifications, knowledge, or experience.

If these conditions are satisfied, the salary income of the spouse shall be clubbed and taxed in the hands of the taxpayer.

Concern - A concern may be any form of business or professional entity, such as a sole proprietorship, partnership firm, or company.

Relative – Relative in relation to an individual means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual.

Substantial Interest -An individual is considered to have a substantial interest in a concern if he or she beneficially holds equity shares carrying at least 20% of the voting power or is entitled to at least 20% of the profits at any time during the previous year.

This provision applies when the spouse receives salary, commission, fees, or any other form of remuneration from such a concern, the individual has a substantial interest in that concern, and the remuneration is not attributable to the spouse's technical or professional qualifications. In such cases, the remuneration received by the spouse is included in the total income of the individual and not taxed separately in the hands of the spouse.

Example- Mr. Sharma has a substantial interest inMrs.Devi ltd. &Mrs. Devi is employed by Sharma Ltd. Without any technical or professional qualification. In this case salary income of Mrs. Sharma shall be taxable in the hands of Mr. Mr. Sharma.

When both husband & wife have substantial Interest

Where both the husband & wife have substantial interest in a concern & both are in receipt of the remuneration from such concern, both the remuneration will be included in the total income of husband or wife whose total income excluding such remuneration is greater.

D. Income from asset transferred to spouse [section 64(1) (iv)]

As per Section 64(1) (iv) of the Income Tax Act, income arising from assets transferred to a spouse is clubbed with the income of the transferor if the following conditions are satisfied:

1. The taxpayer is an individual.

2. The individual transfers an asset (directly or indirectly), other than a house property, to his or her spouse made.

3. The transfer is made without adequate consideration.

4. The transfer is not made under an agreement to live apart.

If all the above conditions are fulfilled, any income generated from such asset shall be deemed to be the income of the individual who transferred the asset.

Example:

Mr. P transfers 500 IFCI debentures to his wife without adequate consideration. The interest income earned on these debentures will be included in the total income of Mr. P.

When Section 64(1) (iv) Is Not Applicable

The provisions of Section 64(1) (iv) do not apply in the following cases:

1. Assets are transferred before marriage.

2. Assets are transferred for adequate consideration.

3. On the date of accrual of income, the transferee is not the spouse of the transferor.

4. Assets are transferred in pursuance of an agreement to live apart.

5. Property is acquired by the spouse out of pin money, i.e., allowance given for personal or household expenses.

E. Income from Assets transferred to Son's Wife [sec. 64 (1) (vi)]

According to Section 64(1) (vi) of the Income Tax Act, income arising from assets transferred to a son's wife shall be clubbed with the income of the transferor if the following conditions are satisfied:

1. The taxpayer is an individual asset

2. The asset is transferred to the son's transfer

3. The transfer may be made directly or indirectly.

4. The asset is transferred without adequate consideration.

5. The asset may be retained by the transferee either in its original form or in a converted form.

When these conditions are fulfilled, the income generated from such asset shall be included in the total income of the individual who transferred the asset.

Example – Mr. X transfers without any consideration fixed deposit of Rs. 1, 50,000 with a bank to his daughter – in-law on May 5, 2022. She earns interest income of Rs. 12,500 from such fixed deposit during the year 2022-23.So, In the given case such income shall be included with the income of Mr. X.

F. Clubbing of Income from Assets transferred to a person for the benefit of spouse. [Section 64(1) (VII)]

Income from the assets transferred to a person for the benefit of spouse attract the provisions of section 64(1) (VII) on clubbing of income if:

1. If the taxpayer is an individual.
2. He/she transfers an asset to any person or an association of persons for the benefit of his or her spouse.
3. The transfer of assets is without adequate consideration, and then the income arising from such asset shall be taxable in the hands of the transferor.

   Example-Mr. R transfers 6% debentures of Co. Ltd. worth ₹2,80,000 to Mr. S without adequate consideration, with the condition that the interest income from the debentures shall be used for the benefit of Mrs. R. In this case, the interest income earned on the debentures shall be included in the total income of Mr.R.

G. Clubbing of Income from Assets Transferred for the Benefit of Son's Wife[Section 64(1)(viii)]

The provisions of Section 64(1)(viii) apply where income arises from assets transferred for the benefit of a son's wife. Income from such assets shall be clubbed in the hands of the transferor if the following conditions are satisfied:

1. The taxpayer is an individual.
2. The asset is transferred to any person or an association of persons.
3. The transfer is made for the benefit of the son's wife.
4. The transfer is made without adequate consideration.

In such cases, the income arising from the transferred asset shall be included in the total income of the person who has transferred the asset.

H. Clubbing of Income of Minor Child

[Section 64(1A)]

All income that arises or accrues to a minor child shall be clubbed with the income of that parent whose total income (excluding the income of the minor child) is higher. However, where the parents are separated, the income of the minor child shall be included in the income of the parent who maintains the minor child during the relevant previous year.

Exemption to Parent

[Section 10(32)]

A parent is entitled to an exemption of ₹1,500 per annum in respect of each minor child whose income is clubbed under Section 64(1A).

If the income of the minor child is less than ₹1,500, the exemption shall be restricted to the actual income so included.

Cases Where Section 64(1A) Is Not Applicable

The income of a minor child shall not be clubbed with the income of the parent in the following cases:

1. Income earned by the minor from any manual work.
2. Income earned by the minor from any activity involving the application of personal skills, talent, or specialized knowledge and experience.
3. Income of a minor child suffering from a disability specified under Section 80U.

I. Transfer of asset to Hindu Undivided Family[Section6 64(2)]

When an individual who is a member of Hindu Undivided Family coverts his or as the property of the Hindu Undivided Family after 31st March,1969 without consideration then the income of such property will be included in the total income of the transferer.

Section 64(2) will apply if all the following conditions are satisfied:

1. The taxpayer is an individual
2. The individual transfers self-acquired property
3. Property is transferred to his/her Hindu Undivided Family (HUF)
4. Transfer is made without adequate consideration
5. The transferred property (or income from it) remains in the HUF

Tax Treatment

Income arising from the transferred property is taxable in the hands of the individual (transferor)

Such income will not be taxed in the hands of the HUF

Important point (Partition of HUF)

If the HUF later partitions and the property is allotted to:

Spouse → income will continue to be clubbed in the hands of the individual

Minor child → income will be clubbed under Section 64(1A)

Example

Mr. A transfers his self-acquired house property to his HUF without consideration.

Annual rent from the house is ₹3,00,000.

₹3,00,000 will be taxable in the hands of Mr. A, not in the hands of the HUF.

1.4 Set-off and Carry Forward of Losses

Introduction

In taxation, businesses and individuals do not always earn profits every year. Sometimes they incur losses. To reduce the burden of tax, the Income Tax Act provides a benefit called **set-off and carry forward of losses**.

The Income Tax Act, 1961 provides an important mechanism known as **set-off and carry forward of losses**, which enables taxpayers to adjust losses arising from various sources—such as business or profession, capital losses from shares or property, and interest on borrowed funds for house property—against profits from the same or other eligible sources. Any unadjusted losses may also be carried forward to future years, subject to prescribed conditions. These provisions help reduce overall tax liability and play a significant role in effective tax planning.

Set-off of losses means adjusting the loss from one source of income against profit from another source in the same financial year. It refers to adjustment of losses against the eligible profits of the year. It is governed by **section 70 and section 71** of the Act. This helps reduce the total taxable income for that year.

CARRY FORWARD OF LOSSES

If the loss cannot be fully adjusted in the same year, it can be **carried forward** to future years. This is called **carry forward of losses**. Losses which could not be set off against the income of assessment year are not lapsed, but are allowed to be carried forward to be set off against the income off subsequent years. Carry forward of losses for each head is governed by different sections which define the number of years it can be carried forward for, against which income can be set off etc. In future years, the carried-forward loss can be adjusted against eligible income, subject to certain rules and time limits.

This concept ensures fairness in taxation because tax is charged on real income over a period of time, not just on one year's performance.

SET-OFF OF LOSSES

The set off of losses are further sub divided in two categories:-

1. Set off within the same head of income or inter head set off.

2. Set off against other heads of income or intra head set off.

1. Set off within the same head of income or inter head set off [Section 70]
According to section 70, if there is a net result of loss from any source of income during any assessment year then the loss can be set off against the income of any other source within same head of income.

Under this provision, a loss incurred by the assessee from one source of income can be set off against income from another source under the same head of income, since income under each head is calculated by combining the net results of all sources falling within that head.

In simple terms, a loss from one source can be set off against income from another source, provided both sources fall under the same head of income.

Example: A loss from one house property can be set off against income from another house property.

Exceptions:-

i. Loss from speculation business [Section73 (1)]
ii. Long term capital loss
iii. Loss from activity of owning and maintaining race horses.
iv. No loss can be set off against gains from casual incomes like winning from lotteries, crosswords, puzzles, card games or other gambling.
v. Loss from specified business referred to in Section 35D [Section 73A (1)]
vi. Loss from an exempted source of income.

2. Set off against other heads of income or intra head set off [Section 71]

According to section 71, if there is a net result of loss in respect of any head of income during any assessment year the loss can be set off against the income of any other head of income. Under this section, loss can be set off against income **under other heads**.

Example: Losses from non-speculative business can be set off against house property.

Exceptions to the rule of inter head adjustment

i. Loss from **speculation business**.

ii.Loss under the head "**Profit and gains of business or profession**" against income from salary.

iii.Loss from activity of **owning and maintaining race horses**.

iv.Set off of **losses against casual winnings**.

v.Any loss under **capital gain**.

vi. Loss under the head "**Income from house property**"

vii.Share of loss from **AOP/BOI**.

viii. Loss from sale of **virtual digital assets**.

Illustration 1

The following are the particulars of income and loss of an individual for the Assessment Year 2025–26.

Compute the Gross Total Income under:

(A) Old Tax Regime

Particulars of Income/Loss:

Particulars	Amount (₹)
Income from house property A	12,000
Income from house property B	(18,000)
Income from interest on securities	15,000
Income from other sources (lottery)	5,000
Profit from non-speculation business	40,000
Loss from speculation business	(10,000)
Short-term capital gain (STCG)	25,000
Long-term capital loss (LTCL)	(30,000)

Solution:

(A) Calculation of Gross Total Income under Old Tax Regime

1. Income from House Property

Income from HP A = ₹12,000

Income from HP B =₹ (18,000)

Loss from house property allowed to be set-off (maximum ₹2,00,000 allowed)

Net Income from House Property = ₹ (6,000)

2. Profits & Gains from Business or Profession

Non-speculation business profit = ₹40,000

Less: Speculation loss = ₹ (10,000)

(Speculation loss can be set-off only against speculation profit, so cannot be adjusted here. It will be carried forward.)

Business Income =₹40,000

Speculation Loss to be C/F = ₹(10,000)

3. Capital Gains

STCG = ₹25,000

LTCL = ₹(30,000)

Long-term capital loss can be set-off only against long-term capital gain.

Since there is no LTCG, LTCL will be carried forward.

Taxable Capital Gain = ₹25,000

LTCL to be C/F = ₹(30,000)

4. Income from Other Sources

Interest on securities = ₹15,000

Lottery income = ₹5,000

Total = ₹20,000

5. Computation of Gross Total Income

Particulars		Amount (₹)
Business Income		40,000
Capital Gains	25,000	
Income from Other Sources	20,000	
Loss from House Property		(6,000)
Gross Total Income		79,000

Losses Carried Forward:

Speculation Loss = 10,000

Long-term Capital Loss = 30,000

3. Set-Off and Carry Forward of Loss from House Property [Section 71B]

If in any assessment year there is a loss under the head “Income from House Property”, the loss can first be adjusted against income from any other head (like salary, business, capital gains, etc.) up to a maximum of ₹2,00,000 in the same year.

If the loss is not fully adjusted in the same year, the remaining amount can be carried forward to the next assessment year.

The carried forward loss can be adjusted only against income from house property in future years.

Such loss can be carried forward for a maximum of 8 assessment years immediately following the year in which the loss was first calculated.

For example, loss from one house property can be adjusted against profit from another house property in the same year. After that, if there is still a loss, it can be set off against other heads of income up to ₹2,00,000. Any remaining loss will be carried forward.

Once the loss is carried forward, it can be set off only against income under the same head, i.e., “Income from House Property.”

Carry Forward and Set-Off of Business Losses [Sections 72 & 80]

If a business or professional loss cannot be fully adjusted in the same year due to lack of sufficient income, it can be carried forward to future years.

Conditions for Carry Forward of Business Loss:

i. The loss must arise from a business, profession, or vocation.

ii.The loss should not be from a speculative business.

iii.The carried forward loss can be adjusted against income from any business or profession in future years, but not necessarily the same business in which the loss occurred.

iv.A business loss cannot be set off against income under any other head (like salary or house property).Only the person who incurred the loss can carry it forward and set it off. A successor cannot claim it, except in cases of inheritance.

V.Business losses can be carried forward for a maximum of 8 assessment years immediately following the year in which the loss was incurred.

vi.According to Section 80,to carry forward business loss, the assessee must file the return of loss under Section 139(3) within the due date specified under Section 139(1).

However, this requirement does not apply to:

Loss from house property under Section 71B and

Unabsorbed depreciation under Section 32(2)

4. Losses in Speculation Business [Section 73]

Meaning of Speculative Transaction

Defined under Section 43(5).

A transaction in which a contract for purchase or sale of any commodity, including stocks and shares, is settled otherwise than by actual delivery.

Separate Treatment of Speculation Business

Speculation business is treated as a separate and distinct business.

Therefore:

Speculation loss cannot be set off against normal business income.

It cannot be set off against any other income.

Set-off Rule

Speculation loss can be set off only against speculation profit.

If not fully set off in the same year:

It can be carried forward.

Carry Forward

Can be carried forward for 4 assessment years.

Can be adjusted only against speculation income.

Important:

Loss from trading in derivatives (if eligible under Section 43(5)) is NOT treated as speculative loss.

Explanation for Companies (Deemed Speculation Business)

If a company is engaged in purchase and sale of shares, it is deemed to be carrying on speculation business.

However, this rule does NOT apply to:

Companies whose gross total income mainly consists of:

Interest on securities

Income from house property

Capital gains

Income from other sources

Companies whose principal business is:

Trading in shares

Banking

Granting of loans and advances

Such companies are not treated as speculation business under this explanation.

5. Carry Forward & Set-off of Losses by Specified Businesses [Section 73A]

(Refers to businesses under Section 35AD – e.g., hotel, hospital, infrastructure, etc.)

Set-off Rule

Loss from specified business can be set off only against profit of another specified business.

Carry Forward

Unabsorbed loss can be carried forward to subsequent years.

It can be set off only against specified business income.

Time Limit

No time limit.

Loss can be carried forward indefinitely.

Condition

Return of loss must be filed before due date under Section 139(1).

Important Note

Loss from a new hospital/hotel eligible under Section 35AD can be set off against profits of an existing hospital/hotel even if the existing business is not eligible under Section 35AD.

6. Losses under the Head “Capital Gains” [Section 74]

If there is a loss under capital gains:

1. Short-Term Capital Loss (STCL)

Can be set off against:

Short-term capital gains (STCG)

Long-term capital gains (LTCG)

2. Long-Term Capital Loss (LTCL)

Can be set off only against:

Long-term capital gains (LTCG)

3. Restriction

Capital loss cannot be set off against:

Salary

House property income

Business income

Other sources

4. Carry Forward

Can be carried forward for 8 assessment years.

Must be adjusted only against capital gains.

Losses from the Activity of Owning and Maintaining Race Horses [Section 74A(3)]

i.As per Section 74A(3), any loss incurred from the business of owning and maintaining race horses cannot be adjusted against income from any other source. Such loss can be set off only against income earned from the same activity.

ii.The loss can be carried forward for up to 4 assessment years immediately following the year in which the loss was incurred. It can be set off only against income from the activity of owning and maintaining race horses.

iii.For this purpose, “loss from the activity of owning and maintaining race horses” means the amount by which the stake money earned is less than the revenue expenditure incurred for maintaining the race horses.

Loss = Revenue Expenditure – Stake Money

iv.The term “horse race” refers to a race on which betting or wagering is legally permitted.

v.“Income by way of stake money” refers to the total prize money received by the owner of a race horse when the horse wins, comes second, or secures any lower position in a horse race.

ORDER OF SET-OFF OF LOSSES

According to Section 72(2), the brought forward business loss must be adjusted before setting off unabsorbed depreciation. Therefore, losses and allowances are set off in the following sequence:

i.Current year depreciation, current year capital expenditure on scientific research, and current year expenditure on family planning (to the extent permitted).

ii.Brought forward business or profession loss under Section 72(1).

iii.Unabsorbed depreciation under Section 32(2).

iv.Unabsorbed capital expenditure on scientific research under Section 35(4).

v.Unabsorbed expenditure on family planning [Section 36(1)(ix)]

Illustration 2

Mr. A furnishes the following particulars for the Assessment Year 2025–26:

Business Profit (Current Year) – ₹ 3,50,000

Income from Self-Occupied House Property (Interest on loan u/s 24) – (₹ 1,80,000)

Brought Forward Business Loss (A.Y. 2023–24) – ₹ 90,000

Long-term Capital Loss = ₹ 45,000

Long-term Capital Loss on Shares (STT paid) – ₹ 45,000

Compute:

(i) Taxable Income for A.Y. 2025–26
(ii) Loss, if any, to be carried forward

(Assume Old Tax Regime is opted)

Solution:

Step 1: Income under different heads

(A) Profits & Gains of Business

Business Profit (Current Year) = ₹ 3,50,000

Less: B/F Business Loss = ₹ 90,000

Income from Business = ₹ 2,60,000

(As per section 72, brought forward business loss is set off against business income.)

(B) Income from House Property

Self-occupied house property loss (interest u/s 24) = (₹ 1,80,000)

As per section 71, loss under house property can be set off against other heads up to ₹ 2,00,000 in the same year.

Since total income is sufficient, full ₹ 1,80,000 can be adjusted.

(C) Capital Gains

Long-term capital loss on shares (STT paid) = ₹ 45,000

Since there is no capital gain during the year, this loss cannot be set off.

It will be carried forward for 8 assessment years and can be set off only against long-term capital gains.

Step 2: Computation of Gross Total Income

Business Income (after set-off) = ₹ 2,60,000

Less: House Property Loss = ₹ 1,80,000

Gross Total Income = ₹ 80,000

Step 3: Loss to be Carried Forward

Long-term Capital Loss on shares = ₹ 45,000 (to be carried forward)

FINAL ANSWER

Taxable Income (A.Y. 2025–26) = ₹ 80,000

Loss to be carried forward:

Long-term Capital Loss = ₹ 45,000

Special Provisions relating to set-off and carry forward-set off of losses

1. Section 75 – Losses of Firms

Loss of a firm shall not be carried forward and set-off by the partners.

The firm itself can carry forward and set-off the loss.

In case of change in constitution of firm, normal carry forward provisions apply.

Partner cannot claim firm’s loss in his personal return.

2.Section 78 – Carry Forward and Set-off in Case of Change in Constitution

(1) Change in Shareholding (Business Loss)

In case of change in constitution of a firm:

Loss attributable to a retired/deceased partner cannot be carried forward by remaining partners.

(2) Change in Shareholding of Company (Closely Held Company)

Business loss cannot be carried forward unless:

At least 51% of voting power remains with the same shareholders as on the last day of the year in which loss was incurred.

Commonly called the 51% continuity rule.

Exceptions:

Not applicable in certain cases like:

Change due to death of shareholder

Certain mergers and acquisitions (as per specific conditions)

Section 79 – Carry Forward and Set-off in Case of Closely Held Company

Applies to companies in which public are not substantially interested (Private Companies).

Loss can be carried forward only if:

51% of voting power continues.

 Does not apply to:

Change due to death of shareholder

Change in shareholding of eligible start-ups (subject to conditions)

Section 80 – Submission of Return for Carry Forward of Loss

Loss cannot be carried forward unless:

Return is filed within the due date under Section 139(1).

Exception:

Loss under the head Income from House Property can be carried forward even if return is filed late.

Illustration 3

From the following particulars of income of assessees A, B and C, compute how the capital losses shall be set-off and carried forward for the previous year ending 31-3-2025 under the old tax regime.

(A)

(i) Business income – ₹ 25,000

(ii) Short-term capital loss – ₹ 8,000

(iii)Long-term capital gain (Plot) – ₹ 18,000

(iv) Long-term capital gain on sale of jewellery – ₹ 12,000

(B)

(i) Business income – ₹ 45,000

(ii) Short-term capital loss – ₹ 60,000

(C)

(i) Business income – ₹ 30,000
(ii) Short-term capital gain – ₹ 22,000
(iii) Long-term capital gain (Land) – ₹ 28,000
(iv) Brought forward short-term capital loss – ₹ 70,000

Solution:

(A) Computation of Total Income

Particulars	Amount (₹)	Amount (₹)
Business Income		25,000
Capital Gains:		
LTCG (Plot)	18,000	
LTCG (Jewellery)	12,000	30,000
Less: STCL		(8,000)
Net Capital Gain		22,000
Gross Total Income		47,000

(B) Computation of Total Income

Particulars	Amount (₹)	Amount (₹)
Business Income		45,000
STCL (No CG to set-off)		
Loss to be C/F 60,000		
Gross Total Income		45,000

(C) Computation of Total Income

Particulars	Amount (₹)	Amount (₹)
Business Income		30,000
Capital Gains:		
STCG	22,000	
LTCG (Land)	28,000	
	50,000	
Less: B/F STCL	(50,000)	
Unabsorbed STCL C/F	20,000	
Gross Total Income	30,000	

Illustration 4

The following are the incomes of Mr. X, an Indian resident for the Previous Year 2024–25:

Particulars		₹	
(i)	Income from securities (Gross)	12,000	
(ii)	Income from residential house (computed)		6,000
(iii)	Profits from Cotton business		30,000
(iv)	Income from commission agency business		3,000
(v)	Speculation income		5,000
(vi)	Short-term capital gain		6,000
(vii)	Long-term capital gain		11,000

The following losses are brought forward from A.Y. 2024–25:

Particulars		₹
(i)	Loss from Silk business (discontinued in P.Y. 2022-23)	5,000

(ii)	Loss from agency business	4,000
(iii)	Loss from Cotton business	3,000
(iv)	Speculation loss	7,000
(v)	Short-term capital loss	8,000
(vi)	Long-term capital loss (P.Y. 2022-23)	7,500

Current year depreciation for Cotton business is ₹ 1,000.

You are required to deal with set-off and carry forward of losses under the New Tax Regime.

Solution:

Computation of Gross Total Income

(Under New Tax Regime)

For P.Y. 2024–25

(1) Income from House Property

Income from residential house = ₹ 6,000

(2) Profits and Gains of Business or Profession

(i) Speculation Business

Income from speculation business = 5,000

Less: Set-off of B/F speculation loss = (5,000)

Balance speculation loss carried forward = 2,000

Net Speculation Income = Nil

(ii) Cotton Business (Non-speculative)

Income from Cotton business = 30,000

Less: Current year depreciation = (1,000)

Net Business Income = 29,000

Less: Set-off of B/F losses:

• Cotton business loss = (3,000)

• Silk business loss (discontinued business) = (5,000)

Total set-off = (8,000)

Balance = 21,000

(iii) Commission Agency Business

Income from agency business = 3,000

Less: Set-off of B/F agency loss = (3,000)

Unabsorbed agency loss carried forward = 1,000

Net Income = Nil

Income under the head “Profits and Gains of Business”

= ₹ 21,000

(2) Capital Gains

Long-Term Capital Gain

Long-term capital gain = 11,000

Less: Set-off B/F long-term capital loss = (7,500)

Taxable LTCG = 3,500

Short-Term Capital Gain

Short-term capital gain = 6,000

Less: Set-off B/F short-term capital loss = (6,000)

Unabsorbed STCL carried forward = 2,000

Taxable STCG = Nil

Total Capital Gains = ₹ 3,500

(3) Income from Other Sources

Interest on securities (Gross) = ₹ 12,000

Computation of Gross Total Income

Particulars		₹
Income from House Property	6,000	
Profits & Gains of Business	21,000	
Capital Gains	3,500	
Income from Other Sources	12,000	
Gross Total Income		42,500

Notes:

Loss of discontinued business can be set-off against income of a continued business.

Speculation loss can be set-off only against speculation income.

Long-term capital loss can be set-off only against long-term capital gains.

Short-term capital loss can be set-off against both STCG and LTCG.

Unabsorbed losses will be carried forward as per Income Tax Act provisions.

1.5 Let us sum up

Clubbing of Income (Sections 60–64)

- Clubbing means including another person's income in the assessee's total income.
- Introduced to prevent tax evasion by transferring income/assets to family members.
- Applicable mainly to spouse, minor child, son's wife, HUF, etc.
- Key provisions:
    - Sec 60 – Transfer of income without transfer of asset.
    - Sec 61 – Revocable transfer of asset.
    - Sec 64(1) (ii) – Spouse's remuneration.
    - Sec 64(1) (iv) – Asset transferred to spouse.
    - Sec 64(1) (vi) – Asset transferred to son's wife.
    - Sec 64(1A) – Minor child's income.
    - Sec 64(2) – Transfer to HUF.
- Minor child income clubbed with higher income parent.
- ₹1,500 exemption per minor child (Sec 10(32)).
- Income from manual work or skill of minor is not clubbed.

 Set-off of Losses (Sections 70–71)

- Intra-head set-off (Sec 70): Loss adjusted within same head.
- Inter-head set-off (Sec 71): Loss adjusted against other heads.
- Exceptions:
    - Speculation loss

- Capital loss
- Lottery/casual income
- Race horse loss

 Carry Forward of Losses

- If loss not fully adjusted, it can be carried forward.
- Time limits:
  - House property loss – 8 years
  - Business loss – 8 years
  - Capital loss – 8 years
  - Speculation loss – 4 years
  - Race horse loss – 4 years
- Business loss return must be filed within due date (Sec 139(1)).
- Capital loss can be set off only against capital gains.
- Speculation loss set off only against speculation profit.
- Order of set-off: Current depreciation → B/F business loss → Unabsorbed depreciation.

1.6 Multiple Choice Questions

Questions to check your progress

Q1.The provisions relating to clubbing of income are covered under Sections _____ of the Income-tax Act, 1961.

(a) 60 – 65

(b) 60 – 64

(c) 58 – 64

(d) 59 – 65

Q2.Income arising from transferred assets is taxable in the hands of the transferor in which of the following situations?

(a) When the transfer is revocable

(b) When there is a power to modify the beneficiary or trustees

(c) Both (a) and (b)

(d) None of the above

Q3.Pratik works as a company secretary in Raj ChemPvt. Ltd. And earns ₹20,000 per month. He marries Pooja, who owns 25% shares of the company. What portion of Pratik's salary will be clubbed?

(a) No clubbing will apply

(b) 50% of salary

(c) Entire salary

(d) 25% of salary

Q4.Mr. Vishal owns a let-out property earning rent of ₹10,500 per month from 1.11.2020. Municipal taxes of ₹6,000 were paid on 10.1.2022. His income from other sources (excluding this property) is ₹2, 60,000. What will be his total taxable income?

(a) ₹3, 11,450

(b) ₹3, 44,000

(c) ₹3, 80,000

(d) ₹3, 33,500

Q5.Mr. Rohan converts his self-acquired property into HUF property. In whose hands will the income from such property be taxable?

(a) Mr. Rohan

(b) The HUF

(c) At the discretion of the HUF

(d) None of the above

Q6.For the purpose of clubbing under Section 64(1) (ii), "substantial interest" refers to:

(a) The individual alone

(b) The individual and his/her spouse together

(c) The individual along with a relative

(d) The individual, spouse, and children

Q7.For Section 64(1) (ii), the term "relative" includes:

(a) Spouse, brother, sister

(b) Spouse, brother, or any other individual

(c) Spouse, children, and dependent brother/sister

(d) Spouse, children, and dependent parents, brother, and sister

Q8.A sells 2,000 debentures of ₹100 each to his wife for ₹90,000. The fair market value is ₹1, 80,000. What amount of income will be clubbed in A's hands?

(a) ₹28,000

(b) ₹14,000

(c) ₹25,200

(d) ₹12,600

Q9.P gifts ₹5, 00,000 to his wife, who invests it in a partnership firm and earns ₹2, 65,000 as profit share. What amount will be clubbed in P's income?

(a) ₹2, 65,000

(b) ₹15,000 (assuming exemption up to ₹2, 50,000)

(c) Nil

(d) ₹15,000 if wife is below 60 years and Nil if 60 or above

Q10.When income of a minor child is clubbed with the income of a parent; the parent is entitled to an exemption of:

(a) ₹1,500

(b) ₹1,500 per minor child

(c) Lower of actual income clubbed or ₹1,500 per minor child

(d) No exemption

Q11.Income of a minor child who is suffering from a disability shall be:

(a) Clubbed with the higher earning parent

(b) Taxable in the hands of the minor through guardian/legal representative

(c) Fully exempt

(d) None of the above

Q12.Income earned by a minor from his/her own skill, talent, or manual work shall be:

(a) Clubbed with the parent having higher income

(b) Taxable in the hands of the minor through guardian/legal representative

(c) Exempt from tax

(d) None of the above

Q13.Income of a minor married daughter shall:

(a) Be clubbed in the income of her husband

(b) Be clubbed in the income of the parent whose income (excluding such income) is higher

(c) Not be clubbed and taxable in her own hands

(d) None of the above

Q.14 If any income is to be clubbed under section 64, it will be clubbed under:

(a) The head “Income from Other Sources”

(b) The relevant head to which it belongs

(c) The head “Profits and Gains of Business or Profession”

(d) None of the the above

Q15.A loss arising from businesses covered under section 35AD can be adjusted against:

(a) Income from non-speculative business

(b) Income from speculative business

(c) Income from house property

(d) Profits of the specified business under section 35AD

Q16. Long-term capital loss is allowed to be set-off against:

(a) Speculation income

(b) Short-term capital gain only

(c) Both long-term capital gain and short-term capital gain

(d) Salary income

Q17. Unabsorbed depreciation can be carried forward and adjusted for:

(a) Next 4 assessment years

(b) Next 8 assessment years

(c) Unlimited period

(d) Next 2 assessment years

Q18. Loss incurred from derivative transactions is considered as:

(a) Non-speculative business loss

(b) Speculative business loss

(c) Casual loss

(d) Capital loss

Q19. Casual loss can be set-off against:

(a) Casual income

(b) Speculation income

(c) Capital gain

(d) None of the above incomes

Q20.While making intra-head adjustment, loss from the business of owning and maintaining race horses can be set off against only.

(a) Income from winnings from lotteries

(b) Income from crossword puzzles

(c) Income from business of owning and maintaining race horses

(d) Income from card game

Answers to check your progress

1-(b), 2-(c), 3-(a), 4-(d), 5-(a), 6-(b), 7-(a), 8-(d), 9-(c), 10-(c), 11-(b), 12-(b), 13-(b), 14-(b), 15-(d), 16-(c), 17-(c), 18-(a), 19-(d), 20-(c)

1.7 Further Reading

Meaning & Purpose of Clubbing

- Tax is charged on total income of an individual.
- To prevent shifting income to lower tax bracket relatives.
- Clubbed income is called “deemed income.”

 Important Clubbing Situations

1. Transfer of income without asset (Sec 60)
2. Revocable transfer (Sec 61)
3. Spouse salary from concern (Sec 64(1)(ii))
4. Asset transferred to spouse (Sec 64(1)(iv))
5. Asset transferred to son's wife (Sec 64(1)(vi))
6. Transfer for benefit of spouse/son's wife
7. Minor child income (Sec 64(1A))
8. Transfer to HUF (Sec 64(2))

 Minor Child Income

- Clubbed with higher income parent.
- ₹1,500 exemption per child.
- Not applicable to:
    - Manual work income
    - Talent/skill income
    - Disabled child (Sec 80U)

 Set-off Rules

- Same head first (Sec 70).
- Other heads next (Sec 71).
- Certain losses have restrictions.
- House property loss adjustable up to ₹2, 00,000 per year.

 Carry Forward Rules

- House property – 8 years.
- Business loss – 8 years.
- Capital loss – 8 years.
- Speculation – 4 years.
- Specified business (Sec 35AD) – Unlimited.
- Return must be filed in time (Sec 80 condition).

 Capital Loss Adjustment

- STCL → STCG + LTCG.
- LTCL → Only LTCG.
- Cannot set off against salary or business income.

 Speculation Loss

- Separate business.
- Set off only against speculation profit.
- Carry forward 4 years.

 Important Sections for Exams

- Sec 60–64 → Clubbing
- Sec 70–71 → Set-off
- Sec 71B → House property loss
- Sec 72 → Business loss
- Sec 73 → Speculation loss
- Sec 74 → Capital loss
- Sec 80 → Filing return condition

1.8 Very Short Answer Type Questions

1. Write the meaning of “Deemed Income”.

2. Explain the meaning of “Aggregation of Income”.

3. Explain the meaning of “Converted Asset”.

4. Give the meaning of “Clubbing of Income”.

5. State the rate of income-tax applicable to unexplained incomes.

6. What is carry forward of losses?

7. What is inter head adjustment of losses?

8. What do you mean by unabsorbed depreciation?

1.9 Short Answer Type Questions

1. Define “Revocable Transfer”.

2. What is meant by “Substantial Interest”?

3. How is the income of a minor child included in the income of his/her parents?

4. Difference between set off and carry forward of losses.

5. Explain the order of set off losses.

6. Explain the process of set off of losses and carry forward in respect of inter source adjustment under the same head of income.

1.10 Essay Type Questions

1. What is meant by clubbing of income? Under what circumstances is the income of one person treated as the income of another person?

2. “An assessee is not only liable in respect of his own income for tax purposes, but his liability may extend to the income of others also.” Comment on this statement.

3. State the provisions relating to set-off and carry forward of brought forward losses.

4. Briefly explain the provisions of inter-head set-off of losses with suitable examples.

1.11 Practical Problems

1. The following particulars relating to the income of Mr. Sunil and the members of his family are available for the previous year 2022–23:

i) Mr. Sunil is engaged in a retail business and earned an income of ₹18, 00,000 during the year.

ii) On 16 October 2021, Mr. Sunil transferred an immovable property to his wife before marriage. His wife earned an income of ₹2, 40,000 from this property during the previous year 2022–23.

iii) Mr. Sunil owns a house property which was gifted to him by his grandfather three years ago. He uses the house for his own residence and paid ₹68,000 as interest on a loan taken for repairing the house.

iv) Mr. Sunil has two minor children. The daughter lives with him, while the son resides with their grandfather for the purpose of studies. During the previous year, the son earned ₹7,800 as interest on fixed deposits in a bank, and the daughter earned ₹6,120 as interest from a Sukanya Samriddhi Account.

You are required to compute the total income of Mr. Sunil for the assessment year 2023–24. [Answer: 17, 76,300]

2. How are the following incomes treated under the Income-tax Act, 1961?

(a) Mr. A gifted ₹1, 00,000 to his son B on his 16th birthday (2nd October, 2023). The amount was deposited in a nationalised bank @ 10% p.a. During the year ending 31st March, 2025, B received ₹10,000 as interest income.

(b) A minor C earned interest @ 10% p.a. on a fixed deposit of ₹2,00,000 in a partnership firm in which his father and mother are partners. The total income of the firm is ₹15,000, which is taxed under the new tax regime.

[Hints: Exemption of ₹1,500 u/s 10(32) is available under the old tax regime. Exemption u/s 10(32) is not allowed if the parent is taxed under the new tax regime. If the parent is taxed under the new tax regime, the minor's income is to be clubbed with the mother's income. Exemption u/s 10(32) is not available when the parent is taxed under the new tax regime.]

3. An assessee was engaged to be married to R. The engagement was announced on 30-09-2023, and the marriage took place on 05-10-2023. The assessee transferred ₹1, 00,000 debentures to R on 12-10-2023. Interest of ₹15,000 on these debentures was received during the assessment year 2024-25.

The Income-tax Officer (ITO) contends that the interest income should be clubbed in the hands of the assessee.

You are required to discuss whether the contention of the ITO is correct or not, giving reasons.

[Hints: No clubbing arises because on the date of transfer of debentures, R was not the wife of the assessee. Hence, the interest income is not includible in the assessee's total income.]

4. Mr. X gifted gold jewellery worth ₹1, 00,000 to his wife Mrs. X on 01-01-2004, which was acquired by him on the same day.

On 01-05-2004, Mrs. X sold the jewellery for ₹1, 25,000 and invested the sale proceeds in a plot for ₹2, 40,000. The remaining amount was paid by her out of her own funds. The plot was sold on 01-07-2024 for ₹10, 50,000.

Compute the income chargeable to tax in the hands of Mr. X and Mrs. X on the sale of jewellery as well as the plot, if the Cost Inflation Index (CII) is as follows:

CII for 2001-02: 100

CII for 2003-04: 109

CII for 2024-25: 363

Additional Information:

Previous year 2004-05:

Mr. X's LTCG: ₹1, 45,327

Mrs. X's LTCG: ₹1, 33,700

Mr. X's STCG on jewellery: ₹25,000

[Hints: Apply clubbing provisions u/s 64(1) (iv).Capital gains attributable to the gifted amount shall be clubbed in the hands of Mr. X. Capital gains attributable to Mrs. X's own investment shall be taxable in her hands.]

5. Mr. X gifted gold jewellery worth ₹ 1, 00,000 to his wife Mrs. X on 1-1-2004. The jewellery had been purchased by him on the same date.

On 1-5-2004, Mrs. X sold the jewellery for ₹ 1, 25,000 and invested the entire sale proceeds in purchasing a plot for ₹ 2, 40,000. The balance amount required for purchase of the plot was paid by Mrs. X out of her own funds.

The plot was sold on 1-7-2024 for ₹ 10, 50,000.

Cost Inflation Index (CII):

FY 2004-05 = 100

FY 2003-04 = 109

FY 2024-25 = 363

Mr. X's Long-term Capital Gain (LTCG) is ₹ 1, 45,327.

Mrs. X's Long-term Capital Gain (LTCG) is ₹ 33,700.

Compute the income chargeable to tax in the hands of Mr. X and Mrs. X.

[Hints: Taxable Income, In the hands of Mr. X: STCG on jewellery = ₹ 25, 000, LTCG (clubbed portion from plot) = ₹ 1, 45,327; Total taxable capital gain = ₹ 1, 70,327

In the hands of Mrs. X: LTCG on own investment portion of plot = ₹ 33,700; Total taxable capital gain = ₹ 33,700]

6. From the following particulars, compute the Total Income of Mr. Raj under the New Tax Regime for the Previous Year 2024–25.

Particulars:

Income from Let-out House (computed) – ₹ 8,000

Annual Rental Value of Self-occupied House – ₹ 5,000

Municipal Taxes paid – ₹ 600

Profit from mobile accessories business (after depreciation) – ₹ 12,000

Profit from commission agency business – ₹ 4,000

Speculation gain from silver – ₹ 3,500

Long-term Capital Gain from Land – ₹ 6,000

Short-term Capital Gain – ₹ 3,000

Brought Forward Losses from P.Y. 2023–24:

Loss from mobile accessories business – ₹ 7,000

Loss from commission agency business – ₹ 2,000

Speculation loss – ₹ 2,500

Unabsorbed Depreciation – ₹ 1,500

Long-term Capital Loss (Land) – ₹ 2,000

Short-term Capital Loss – ₹ 1,000

[Hints: Income from Let-out House to be taken as ₹ 8,000 (already computed).Self-occupied house is exempt under New Tax Regime. Business income after set-off = ₹ 5,500.Long-term Capital Gain after adjustment = ₹ 4,000.Short-term Capital Gain after adjustment = ₹ 2,000.Speculation loss unadjusted ₹ 1,000 to be carried forward. Gross Total Income = ₹ 19,500.]

7. The assessment of R Co. Ltd., an Indian company, for the Assessment Years 2024–25 and 2025–26 shows the following results:

(A) Assessment Year 2024–25

Interest on securities – ₹ 3,000

Income from House Property – ₹ 10,000

Profits and Gains of Business or Profession:

(a) Trading in textiles – Loss ₹ 40,000

(b) Manufacturing steel:

Profit before depreciation – ₹ 70,000

Depreciation – ₹ 90,000

(c) Speculation business – Profit ₹ 15,000

Income from Other Sources (Bank Interest) – ₹ 8,000

Short-term Capital Gains – ₹ 5,000

(B) Assessment Year 2025–26

Interest on securities – ₹ 4,000

Income from House Property – ₹ 12,000

Profits and Gains of Business or Profession:

(a) Trading in textiles – Profit ₹ 18,000

(b) Manufacturing steel – Profit ₹ 1, 60,000

(c) Speculation business – Loss ₹ 12,000

Income from Other Sources (Bank Interest) – ₹ 6,000

Short-term Capital Loss – ₹ 30,000

Required:

Compute the Total Income of the company for both Assessment Years under the old tax regime, giving full reasons for your workings. Also show the amount of loss, if any, to be carried forward.

[Hints: Assessment Year 2024–25:Manufacturing business: Profit before depreciation ₹ 70,000,Depreciation ₹ 90,000Current depreciation adjusted to the extent of ₹ 70,000,Unabsorbed depreciation ₹ 20,000 to be carried forward Textile trading loss ₹ 40,000:Set off against speculation profit ₹ 15,000,Balance ₹ 25,000 set off against other business/other heads as permitted. Total Income for the year may become Nil after set-off. Losses to be carried forward: Business loss (if any balance remains) Unabsorbed depreciation ₹ 20,000.Assessment Year 2025–26: Brought forward business loss to be set off before unabsorbed depreciation. Speculation loss ₹ 12,000 can be set off only against speculation profits (if any), otherwise carried forward. Short-term capital loss ₹ 30,000 to be carried forward if no capital gains available for set-off.]

8. Following are the particulars of income and losses of Mr. Mohan, an individual, for the Assessment Year 2025-26, chargeable under the old tax regime.

You are required to compute his Gross Total Income.

Current Year Incomes / Losses

Particulars	Amount (₹)
Profit from Business A	80,000
Loss from Business B	(20,000)
Loss from Speculation Business C	(60,000)
Short-term capital gain	50,000
Long-term capital loss	(20,000)

Interest on securities	24,500
Income from owning and maintaining race horses	15,000
Income from lotteries (gross)	20,000
Income from card games	16,000
Loss from gambling	(6,000)

Brought Forward Losses

Nature of Loss	Assessment Year	Amount (₹)
Long-term capital loss	2022-23	4,000
Short-term capital loss	2023-24	10,000
Unabsorbed depreciation	2021-222	5,000
Loss from race horses	2020-21	10,000
Loss from race horses	2021-22	18,000
Business loss (Business A)	2018-19	18,000

Required:

Compute the Gross Total Income of Mr. Mohan for A.Y. 2025-26.

[Hints: Brought forward business loss of A.Y. 2018-19 cannot be set off (time limit over).

Business income after adjustments = ₹17,000.

Long-term capital loss can be set off only against LTCG.

Short-term capital loss can be set off against STCG/LTCG.

Taxable STCG = ₹40,000.

Loss from gambling cannot be set off.

Speculation loss can be set off only against speculation profit and hence carried forward.

Race horse loss of A.Y. 2020-21 cannot be set off; loss of A.Y. 2021-22 set off up to ₹15,000.

Income from other sources = ₹60,500.

Gross Total Income = ₹1, 17,500]

□□□

UNIT 10: DEDUCTIONS UNDER CHAPTER VI-A

UNIT STRUCTURE

10.1 Learning Objectives

10.2 Introduction

10.3 Incomes Not Eligible for Claiming Deductions u/s 80

10.4 Overall Maximum Limit of Deduction u/s 80

10.5 Various Deductions u/s 80

10.5.1 Investment Related Deductions (80C to 80GGC)

10.5.2 Income Related Deduction (Section 80IA to 80U)

10.6 Computation of Total Income after Deductions

10.7 Let Us Sum Up

10.8 Answers to Check Your Progress

10.9 Further Reading

10.10 Model Questions

10.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- Understand the concept of Gross Total Income and the role of Chapter VI-A deductions.
- Identify specific incomes that do not qualify for Section 80 deductions.
- Apply the statutory rules regarding the maximum overall limit of deductions.
- Explain major investment and payment-related deductions, such as Sections 80C, 80D, and 80G.
- Explain key income and disability-related deductions, including Sections 80TTA, 80TTB, and 80U.
- Compute the final Taxable Income of an assessee by correctly applying these deductions in practical scenarios.

10.2 INTRODUCTION

According to Section 80B (5) of the Income Tax Act, Gross Total Income refers to the total income calculated in accordance with the provisions of the Act before allowing any deductions under Chapter VI-A (i.e., sections 80C to 80U).

In other words, Gross Total Income represents the combined income under all five heads of income after applying the rules relating to clubbing of income and set-off or carry forward of losses.

For the purpose of determining an assessee's taxable income, deductions specified under sections 80C to 80U are allowed from the Gross Total Income. This implies that income is first computed separately under each of the five heads, and then aggregated to arrive at the Gross Total Income. After this aggregation, eligible deductions under Chapter VI-A are subtracted, and the balance amount constitutes the Total Income or Taxable Income.

It is important to distinguish these deductions from those allowed while calculating income under each head. Deductions made under specific heads of income are generally permitted for expenses that are wholly and exclusively incurred for earning that income. In contrast, deductions under Chapter VI-A are largely provided as incentives for savings, investments, or as relief measures available to taxpayers under certain circumstances.

10.3 INCOMES NOT ELIGIBLE FOR CLAIMING DEDUCTIONS U/S 80

The following incomes are not eligible for deduction under Section 80:

1. Any income which is fully exempt under section 10 (for example, agricultural income, certain allowances etc) is not included in Gross Total Income. Since deductions U/S 80 are allowed only from GTI, exempt income does not qualify.
2. Long term capital gains taxable under Sections 112 and 112A are not eligible for deduction under chapter VI-A.
3. Short term capital gains on equity-oriented mutual funds taxed under Section 111A (at special rates) are not eligible for deduction under chapter VI-A.
4. Income such as winnings from lotteries, crossword puzzles, horse races, card games, gambling, betting etc., taxable under section 115BB, is not eligible for deduction under chapter VI-A.
5. If any income does not form part of total income under the Act, no deduction can be claimed against it.
6. Any income taxed at special rates under various provisions (such as Sections 115A, 115AB, 115AC, 115AD etc) is generally not eligible for deduction under Chapter VI-A unless specifically permitted.

10.4 OVERALL MAXIMUM LIMIT OF DEDUCTION U/S 80

The total amount of deductions under Chapter VI-A shall not be more than Gross Total Income of the assessee. Deductions are allowed only from income that forms part of the Gross Total Income.

10.5 VARIOUS DEDUCTIONS U/ 80

These deductions are divided under two categories:

A. Deductions in respect of certain payments (Section 80C to 80GGC).
B. Deductions in respect of certain incomes (Section 80IA to 80U).

A. Deductions in respect of certain payments

These deductions are mainly available to individual taxpayers and Hindu Undivided Family (HUF). They are generally related to savings, investments, insurance, donations, educations, medical relief etc. Some important sections included under section 80C TO 80GGC are discussed in details below:

10.5.1 Investment Related Deductions (80C to 80GGC)

Savings are essential for the rapid economic growth of a nation. In order to promote the habit of saving, the government provides an incentive in the form of a deduction from taxable income. To properly direct these savings, several approved schemes have been introduced. When an assessee invests or deposits money in these specifies schemes, he or she becomes eligible to claim a deduction.

1. Deductions regarding approved savings in P.F. Life Insurance Premium etc (Sec 80C)

The deduction shall be allowed for the total amount invested or deposited in the approved savings schemes, subject to a **maximum of Rs.150000** per annum, whichever is lower. This overall limit of Rs. 150000 also includes deductions available under sections 80CCC and 80CCD.

Amount saved and deposited by the employee or assessee in following savings schemes shall qualify for deduction u/s 80C.

(a) Deposits made in Provident Funds

- Amount deposited by the employee in statutory provident fund during the previous year fully qualifies for deduction.
- Amount deposited in any recognised provident fund during the previous year fully qualifies for deduction.
- Amount deposited in Public Provident Fund during the previous year fully qualifies for deduction.
- Any investment which is unrecognized by the commissioner of Income Tax will not qualify for any deduction

(b) Payment of Life Insurance Premium

2. **Section 80CCC: Contributions to Pension Funds**

This section focuses on encouraging individuals to build a retirement corpus through insurance-based annuity plans.

- **Eligibility:** Individuals.
- **Maximum Limit:** Rs. 1.5 lakh per financial year.
- **Eligible Payments:** Amounts paid towards specific pension plans or annuity funds offered by the Life Insurance Corporation of India (LIC) or other approved insurers.

3. **Section 80CCD: National Pension System (NPS)**

This section provides tax relief for contributions made to the government-backed National Pension System (NPS). It is divided into three sub-sections:

- **Section 80CCD(1):** Covers the taxpayer's own contribution. Salaried employees can claim up to 10% of their salary, while self-employed individuals can claim up to 20% of their gross total income.
- **Section 80CCD(1B):** Offers an exclusive, additional deduction of up to Rs. 50,000 for voluntary contributions to the NPS Tier-I account.
- **Section 80CCD(2):** Covers the employer's contribution to the employee's NPS account. The deduction is limited to 14% of the salary for Central/State Government employees and 10% for other employees.

4. **Section 80D: Medical Insurance Premiums**

This provision encourages families to secure themselves against healthcare costs.

- **Eligibility:** Individuals and HUFs.
- **Eligible Payments:** Health insurance premiums and preventive health check-up expenses (up to Rs. 5,000).

- **Maximum Limit:** Rs. 25,000 for self, spouse, and dependent children. An additional Rs. 25,000 is allowed for parents' insurance. If the taxpayer or the parents are senior citizens (aged 60 or above), the respective limits increase to Rs. 50,000.

5. **Section 80DD: Maintenance of a Disabled Dependent**

This provides financial relief to taxpayers who are caregivers for disabled family members.

- **Eligibility:** Resident Individuals and HUFs.
- **Eligible Payments:** Medical treatment, nursing, training, and rehabilitation of a dependent with a disability, or payments to specific insurance schemes for their maintenance.
- **Maximum Limit:** A flat deduction of Rs. 75,000 is allowed for normal disability (40% or more). For severe disability (80% or more), the flat deduction increases to Rs. 1,25,000, irrespective of the actual amount spent.

6. **Section 80DDB: Medical Treatment of Specified Diseases**

This section helps offset the high costs associated with treating severe, life-threatening illnesses.

- **Eligibility:** Resident Individuals and HUFs.
- **Eligible Payments:** Medical expenses incurred for treating specific diseases (like malignant cancer, chronic renal failure, or certain neurological diseases) for oneself or a dependent.
- **Maximum Limit:** Up to Rs. 40,000 for regular taxpayers, and up to Rs. 1,00,000 if the patient is a senior citizen.

7. **Section 80E: Interest on Education Loans**

This is designed to make higher education more affordable.

- **Eligibility:** Individuals.
- **Eligible Payments:** The interest portion of an EMI paid on a loan taken from a financial institution for higher studies (for oneself, spouse, or children).
- **Maximum Limit:** There is no monetary cap. The entire interest paid can be deducted for a maximum of 8 consecutive years.

8. **Section 80EE, 80EEA, and 80EEB: Targeted Loan Interest Deductions**

These sections provide additional relief for specific types of loans, promoting homeownership and green energy.

- **Section 80EE:** Allows a deduction of up to Rs. 50,000 on home loan interest for first-time homebuyers (subject to specific loan sanction dates and property values).

- **Section 80EEA:** Provides a deduction of up to Rs. 1.5 lakh on home loan interest specifically for purchasing "affordable housing" (property stamp duty value up to Rs. 45 lakh).
- **Section 80EEB:** Allows a deduction of up to Rs. 1.5 lakh on interest paid for a loan taken to purchase an electric vehicle (EV).

9. **Section 80G: Donations to Charitable Funds and Institutions**

This encourages philanthropy by offering tax benefits on charitable contributions.

- **Eligibility:** All taxpayers.
- **Eligible Payments:** Donations made to prescribed government relief funds (like the Prime Minister's National Relief Fund) and approved charitable organizations. Cash donations exceeding Rs. 2,000 are not eligible.
- **Deduction Rules:** Depending on the specific fund, taxpayers can claim either 100% or 50% of the donated amount. Some donations are subject to a "qualifying limit" of 10% of the adjusted gross total income.

10. **Section 80GG: Deduction for House Rent Paid**

This is a relief measure for people who live in rented accommodations but do not receive a House Rent Allowance (HRA) from their employer.

- **Eligibility:** Individuals.
- **Maximum Limit:** The deduction is capped at the least of the following three:
    1. Rs. 5,000 per month.
    2. 25% of the adjusted total income.
    3. Actual rent paid minus 10% of the adjusted total income.

11. **Section 80GGA: Donations for Scientific Research or Rural Development**

This section aims to fund research and community development.

- **Eligibility:** All taxpayers (except those who have business/professional income, as they claim this under PGBP).
- **Eligible Payments:** Donations to approved universities, research associations, or rural development programs.
- **Maximum Limit:** 100% of the donated amount (cash donations exceeding Rs. 2,000 are restricted).

12. **Section 80GGB: Company Contributions to Political Parties**

This promotes transparent political funding by the corporate sector.

- **Eligibility:** Indian Companies.

- **Eligible Payments:** Contributions made to any registered political party or electoral trust.
- **Maximum Limit:** 100% of the contribution, provided it is made via non-cash modes (e.g., bank transfer, cheque).

13. **Section 80GGC: Individual Contributions to Political Parties**

This serves the same purpose as 80GGB but applies to non-corporate taxpayers.

- **Eligibility:** Any person (except local authorities and artificial juridical persons wholly or partly funded by the government).
- **Eligible Payments:** Contributions to registered political parties or electoral trusts.
- **Maximum Limit:** 100% deduction is allowed, strictly on the condition that the payment is not made in cash

10.5.2 Income Related Deduction (Section 80IA to 80U)

1. Section 80TTA: The Savings Account Relief

Think of Section 80TTA as a small tax reward for keeping your everyday money in the bank. Almost everyone has a savings account, and the little bits of interest you earn on it are taxable. Section 80TTA steps in to protect a portion of that interest from being taxed.

- **Eligible Assessee:** Individuals (who are under 60 years old) and Hindu Undivided Families (HUFs).
- **Eligible Income:** Interest earned purely from **Savings Bank Accounts**. This account can be with a standard bank, a cooperative bank, or even a post office.
- **Maximum limit?** The deduction is capped at **₹10,000** per financial year.
- Section 80TTA does *not* cover interest from Fixed Deposits (FDs), Recurring Deposits (RDs), or company bonds. It is strictly for savings accounts.

2. Section 80TTB: The Senior Citizen Advantage

Section 80TTB is a special, upgraded version of 80TTA created exclusively to help the elderly. Since senior citizens often rely heavily on interest income for their daily expenses, the government gives them a much wider safety net.

- **Eligible Assessee:** Resident Senior Citizens (Individuals aged 60 years or more at any time during the financial year).
- **Eligible Income:** Interest earned on **any type of deposit**. Unlike 80TTA, this includes Savings Accounts, Fixed Deposits (FDs), and Recurring Deposits (RDs) held with banks, post offices, or cooperative societies.
- **Maximum limit?** A generous cap of **₹50,000** per financial year.

- **The Golden Rule:** A senior citizen claiming Section 80TTB cannot also claim Section 80TTA. They only get the benefit of this higher ₹50,000 limit.

3. Section 80U: Relief for Taxpayers with a Disability

While 80TTA and 80TTB are about income, Section 80U is about the taxpayer's personal health circumstances. It recognizes the extra financial burden of living with a disability and offers a straightforward, flat tax relief.

- **Eligible Assessee:** A Resident Individual who has been officially certified by a recognized medical authority as a "person with a disability."
- **Eligible Income:** This is a **flat deduction**. The beauty of Section 80U is that the taxpayer does not need to submit actual medical bills or prove their hospital expenses. Just holding the valid medical certificate is enough to claim the full amount.
- **Maximum limits:** The amount depends entirely on the severity of the disability:
    - **Normal Disability (At least 40% but less than 80%):** A flat deduction of **₹75,000**.
    - **Severe Disability (80% or more):** A flat deduction of **₹1,25,000**.

10.6 COMPUTATION OF TOTAL INCOME AFTER DEDUCTIONS

ILLUSTRARTION 1

Mr. Sharma took out medical insurance for his family members and paid the following premiums during the previous year:

S.No.	Particulars	Amount (₹)
1.	Medical insurance premium of self paid by cheque	12,000
2.	Medi-claim premium of wife paid in cash	6,000
3.	Medical insurance premium of 14-year-old daughter paid by UPI	4,000
4.	Medi-claim premium paid on the medical insurance of his father and mother (Senior Citizens) by net banking	28,000

S.No.	Particulars	Amount (₹)
5.	Medi-claim premium on the policy of dependent younger sister	5,000
6.	Preventive medical check-up of self and wife paid in cash	3,000

Calculate the eligible amount of deduction under section 80D for Mr. Sharma.

SOLUTION

Calculation of Amount of Deduction u/s 80D for Mr. Sharma

A. For Self, Spouse, and Dependent Children:

- Medical insurance premium of self (paid by cheque): ₹ 12,000
- Medi-claim premium of wife (paid in cash - Not Eligible): NIL
- Medical insurance premium of dependent daughter (paid by UPI): ₹ 4,000
- Preventive medical check-up of self & wife (cash allowed): ₹ 3,000 Subtotal for Self & Family: ₹ 19,000 Deduction Allowed: Actual amount paid ₹ 19,000 OR Maximum Limit ₹ 25,000 (whichever is less) = ₹ 19,000

B. For Parents (Senior Citizens):

- Medi-claim premium of father and mother: ₹ 28,000 Deduction Allowed: Actual amount paid ₹ 28,000 OR Maximum Limit ₹ 50,000 (whichever is less) = ₹ 28,000

C. For Dependent Sister:

- Medi-claim premium for dependent sister (Not Eligible): NIL

TOTAL AMOUNT ALLOWED AS DEDUCTION U/S 80D (A + B + C): ₹ 47,000

ILLUSTRATION 2

Mr. Kapoor, a resident individual aged 63 years, is certified by a medical authority as a person with a normal physical disability. He submits the following particulars of his income and investments for the year ended 31-03-2024:

1. Income from House Property:

- Rent received from a house in Mumbai: ₹ 30,000 p.m.
- Municipal Taxes paid by the owner (Mr. Kapoor): ₹ 20,000
- Municipal Taxes paid by the tenant: ₹ 10,000
- Expenses on repairs: ₹ 15,000

2. Income from Business & Profession:

- Net income from dairy farming business: ₹ 85,000 (Before deducting the below item)
- He paid ₹ 15,000 to an approved agricultural research institute.

3. Speculation Business:

- Speculation gain from silver: ₹ 25,000
- Speculation loss from shares: ₹ 40,000

4. Income from Other Sources:

- Dividend from an Indian company: ₹ 12,000
- Interest on Bank Fixed Deposits (FD): ₹ 65,000
- Interest on Post Office Savings Account: ₹ 10,000

5. Investments and Payments:

- He contributed ₹ 40,000 towards the annuity pension plan of LIC.

Calculate his Total Taxable Income for the Assessment Year 2024-25 (assuming he opts for the Old Tax Regime).

SOLUTION

Computation of Total Income of Mr. Kapoor for A.Y. 2024-25

Particulars	**Details (₹)**	**Amount (₹)**
1. Income from House Property		
Gross Annual Value (₹ 30,000 x 12 months)	3,60,000	
Less: Municipal Taxes (Only taxes paid by owner are allowed)	20,000	

Particulars	Details (₹)	Amount (₹)
Net Annual Value (NAV)	3,40,000	
Less: Standard Deduction u/s 24(a) @ 30% of NAV	1,02,000	
Income from House Property		**2,38,000**
2. Profits and Gains of Business or Profession		
Income from Dairy Farming	85,000	
Less: Payment to approved agricultural research institute	15,000	
Income from Business		**70,000**
3. Capital Gains / Speculation Business		
Speculation Gain from silver	25,000	
Less: Speculation Loss from shares	40,000	
Net Speculation Loss to be carried forward (Cannot set off against other heads)	*(15,000)*	**NIL**
4. Income from Other Sources		
Dividend from an Indian company	12,000	

Particulars	Details (₹)	Amount (₹)
Interest on Bank Fixed Deposits (FD)	65,000	
Interest on Post Office Savings Account	10,000	
Income from Other Sources		**87,000**
GROSS TOTAL INCOME (1 + 2 + 3 + 4)		**3,95,000**
Less: Deductions under Chapter VI-A		
Deduction u/s 80CCC (Contribution to LIC Pension Fund)	40,000	
Deduction u/s 80TTB (Eligible Interest: ₹75,000. Maximum allowed: ₹50,000)	50,000	
Deduction u/s 80U (Person with Normal Disability - Flat Deduction)	75,000	
Total Deductions	*1,65,000*	**(1,65,000)**
TOTAL TAXABLE INCOME		**2,30,000**

CHECK YOUR PROGRESS

1) According to Section 80B (5), Gross Total Income refers to the total income calculated before allowing any deductions under Chapter VI-A, which covers sections 80C to _____.
2) Are long-term capital gains taxable under Sections 112 and 112A eligible for deductions under Chapter VI-A?
3) The total amount of deductions under Chapter VI-A shall not be more than the _____ of the assessee.
4) What is the maximum overall limit of deduction available per annum for investments in approved savings schemes under Section 80C?
5) Section 80CCD(1B) offers an exclusive, additional deduction of up to Rs. 50,000 for voluntary contributions to which account?
6) Under Section 80D, what is the maximum limit for medical insurance premiums if the taxpayer or their parents are senior citizens (aged 60 or above)?
7) For how many consecutive years can a taxpayer claim a deduction on the interest portion of an education loan under Section 80E?
8) Cash donations exceeding what amount are not eligible for a deduction under Section 80G?
9) True or False: A senior citizen claiming the ₹50,000 limit under Section 80TTB can also claim the Section 80TTA deduction.
10) True or False: Under Section 80U, a taxpayer with a severe disability (80% or more) must submit actual medical bills to claim the flat deduction of ₹1,25,000

10.7LET US SUM UP

- Chapter VI-A deductions are tax reliefs subtracted from a taxpayer's Gross Total Income (GTI) to calculate their final Taxable Income.
- The total amount of these deductions can never exceed the GTI. Additionally, they cannot be claimed against special tax-rate incomes like Long-Term Capital Gains or lottery winnings.
- Deductions fall into two groups: those based on **investments/payments** (like Section 80C for savings, 80D for medical insurance, and 80G for donations) and those based on **incomes/conditions** (like Section 80TTA for savings interest and 80U for disabilities).
- The Income Tax Act offers higher deduction limits to vulnerable groups, particularly senior citizens (e.g., under 80D and 80TTB) and persons with disabilities (e.g., under 80U).

- Utilizing these deductions helps taxpayers legally minimize their tax liability while encouraging savings, philanthropy, and financial security.

10.8 ANSWERS TO CHECK YOUR PROGRESS

Answer to Question no 1:80U

Answer to Question no 2: No. Long term capital gains taxable under Sections 112 and 112A are not eligible for deduction under Chapter VI-A.

Answer to Question no 3: Gross Total Income

Answer to Question no 4: Rs. 1,50,000

Answer to Question no 5:NPS Tier-I account

Answer to Question no 6: Rs. 50,000

Answer to Question no 7: 8 consecutive years

Answer to Question no 8: Rs. 2,000

Answer to Question no 9: False. A senior citizen claiming Section 80TTB cannot also claim Section 80TTA.

Answer to Question no 10:False. Under Section 80U, the taxpayer does not need to submit actual medical bills; holding a valid medical certificate is enough to claim the full amount.

10.9 FURTHER READING

- Singhania, Dr. V. K., & Singhania, Dr. Monica. Students' Guide to Income Tax (Latest Assessment Year). Taxmann Publications.
- The Institute of Chartered Accountants of India (ICAI). Study Material for Taxation (Income-tax Law). Chapter on 'Deductions from Gross Total Income'. Available on the ICAI Board of Studies (BoS) Knowledge Portal: www.icai.org.
- Government of India. The Income-tax Act, 1961 (Bare Act). Specifically refer to Chapter VI-A (Sections 80A to 80U) for the official legal provisions. Available at the official Income Tax Department website: www.incometaxindia.gov.in.

10.10 MODEL QUESTIONS

interest. Calculate total Chapter VI- Q1. Compute the total eligible deductions of Mr. Akash (Age 42 years) under Chapter VI-A for the current Assessment Year from the following case.

- Gross Total Income: ₹ 6,50,000
- Interest earned from Savings Bank Account: ₹ 14,000
- Interest earned from Bank Fixed Deposits (FD): ₹ 25,000
- Medical condition: He is certified by a medical authority as having a disability of 60%.

Q2. Mrs. Gupta, a resident senior citizen aged 66 years, is certified by a recognized medical authority as a person with a severe disability (85% impairment). She submits the following particulars of her income and investments for the year ended 31-03-2024:

1. Income from House Property:

- Rent received from a commercial shop: ₹ 40,000 p.m.
- Municipal Taxes paid by Mrs. Gupta: ₹ 30,000

2. Income from Business:

- Net profit from her boutique business: ₹ 1,50,000

3. Income from Other Sources:

- Interest on Bank Fixed Deposits (FD): ₹ 80,000
- Interest on Savings Bank Account: ₹ 15,000
- Dividend from an Indian company: ₹ 20,000

4. Investments and Payments:

- Medical insurance premium paid for self by cheque: ₹ 45,000
- Preventive health check-up for self paid in cash: ₹ 5,000

Calculate her Total Taxable Income for the Assessment Year 2024-25 (assuming she opts for the Old Tax Regime).

Q3. Explain the provisions of Section 80D regarding medical insurance premiums. Highlight the different monetary limits applicable to normal individuals versus senior citizens.

Q4. Mr. X (Age 35) earns ₹ 12,000 as savings account interest and ₹ 15,000 as FD interest. He paid ₹ 18,000 for his own medical insurance by UPI. Calculate total Chapter VI-A deductions.
Q5. Miss Z (Age 28) pays ₹ 20,000 by cheque for her medical insurance and ₹ 45,000 by net banking for her senior citizen father's medical insurance. Calculate her eligible deduction under section 80D.
Q6. Mr. Y (Age 65), suffering from a certified severe disability (85%), earns ₹ 8,000 from savings interest and ₹ 60,000 from FD A deductions.

UNIT 11: TAX COMPUTATION, REBATE, RELIEF AND MARGINAL RELIEF

UNIT STRUCTURE

11. 1 Learning Objectives

11.2 Introduction

11.3 Computation of Total Income and Tax Liability

11.4 Rates of Tax

- 11.4.1 Individuals
- 11.4.2 HUF
- 11.4.3 Firm
- 11.4.4 Company

11.5 Surcharge

11.6 Health and Education cess

11.7 Rebate u/s 87A

11.8 Relief u/s 89

11.9 Marginal Relief

11.10 Practical Problems

11.11 Let Us Sum Up

11.12 Answers to Check Your Progress

11.13 Further Readings

11.14 Model Questions

11.1 Learning Objectives

After studying this unit, you will be able to:

- Apply the correct rates of income tax for individuals (under both the Old and New Tax Regimes), HUFs, firms, and companies for the relevant assessment year.
- Compute the surcharge applicable to different categories of taxpayers based on their total income.
- Apply the Health and Education Cess on the total tax and surcharge.

- Compute and apply the rebate under Section 87A and relief under Section 89.
- Prepare a complete, step-by-step computation of income tax liability for individuals and other entities with illustrations.

11.2 Introduction

In the previous units, we have discussed about the various heads of income that has been classified as per the Income Tax Act, 1961. In this unit, we shall discuss computation of total income and tax liability thereon of an assessee.

Having understood what constitutes income, how it is classified under the five heads, which exemptions apply, and what deductions are available, we now arrive at the final — and most practical — step: computing the actual tax payable. Computing income tax liability is the culmination of all the knowledge built across the preceding units of this study material.

Tax computation in India is not a single calculation but a structured, multi-step process. One begins by aggregating income from all heads into the Gross Total Income (GTI), then subtracts eligible deductions under Chapter VI-A to arrive at the Total Income (TI). The TI is rounded off and then subjected to the applicable tax rates — which differ significantly depending on the category of the taxpayer (individual, HUF, firm, or company) and, for individuals, on whether they have opted for the Old Tax Regime or the New Tax Regime.

On the basic tax computed, a surcharge may apply if income exceeds specified thresholds, and a Health and Education Cess of 4% is invariably levied on the tax plus surcharge. Certain individuals are then entitled to a rebate under Section 87A, which reduces the final tax payable. Taxpayers who receive arrears of salary can claim relief under Section 89(1) to avoid the harsh bunching effect. And where the surcharge or the loss of Section 87A rebate creates a perverse outcome — where a person with higher income pays more tax net of surcharge than a person just below the threshold — marginal relief steps in to correct that anomaly.

11.3 Computation of Total Income and Tax Liability

Once we have calculated the Total Income, the income tax liability is computed through the following structured steps. This framework usually applies to all categories of assessees, with the applicable rates and thresholds varying by category.

Step	**Action**	**Amount (Rs.)**
1	Compute Total Income (TI) after all deductions and rounding off	XXX
2	Apply applicable tax slab rates on TI to get Income Tax before special rates	xxx
3	Add: Tax on special rate incomes (STCG u/s 111A @ 20%,	xxx

	LTCG u/s 112A @ 12.5%, LTCG u/s 112 @ 20%, etc.)	
4	Total Income Tax (Step 2 + Step 3)	xxx
5	Less: Rebate under Section 87A (for eligible individuals — TI ≤ Rs. 5,00,000 under Old Regime; TI ≤ Rs. 7,00,000 under New Regime)	(xxx)
6	Tax after Rebate (Step 4 − Step 5). If negative, tax = Nil.	xxx
7	Add: Surcharge (on tax in Step 6, at applicable rates based on TI)	xxx
8	Apply Marginal Relief on Surcharge (if applicable)	(xxx)
9	Tax + Surcharge (after marginal relief)	xxx
10	Add: Health and Education Cess @ 4% of (Tax + Surcharge) [Step 9]	xxx
11	GROSS TAX LIABILITY (Step 9 + Step 10)	XXX
12	Less: Relief u/s 89(1) (for arrears / advance salary, if applicable)	(xxx)
13	Less: Tax Deducted at Source (TDS)	(xxx)
14	Less: Advance Tax paid during the year	(xxx)
15	Less: Self-Assessment Tax paid (if any)	(xxx)
16	**NET TAX PAYABLE / (REFUNDABLE) [Steps 11 − 12 − 13 − 14 − 15] — Round off to nearest rupee u/s 288B**	**XXX / (XXX)**

11.4 Rates of Tax

Income-tax is to be charged on every person at the rates prescribed for the year by the Annual Finance Act or the Income-tax Act, 1961 or both. Every year the Finance Act introduces important updates to income tax rates and surcharge structures for the assessment year

starting from 1st April.Section 2 of the Finance Act read with Part I of the First Schedule to the Finance Act seeks to specify at which income-tax is to be levied on income chargeable to tax for the relevant assessment year.

- Part II specifies the rates at which tax is deductible at source for the current Financial Year.
- Part III gives the rates for calculating income-tax for deducting tax from income chargeable under the head “Salaries” and computation of advance tax for the relevant Financial Year, where the assessee exercises the option to shift out of the default tax regime provided under section 115BAC(1A).
- Part IV contains the rules for computing net agricultural income

Further, the Finance Act prescribes the rates of tax, in respect of certain income, the Income Tax Act itself has prescribed specific rates, e.g. Lottery income is taxed @30% (Sec 115BB), Long Term Capital Gain is to be taxed @ 20% (Sec 112), Short Term Capital Gain on listed shares u/s 111A is to be taxed @ 15% etc.

Thus, Income tax rates in India are determined annually by the Finance Act, specifying slabs, rates, and surcharges for different categories of taxpayers besides the specific rates on certain incomes prescribed by the Income Tax Act itself. We shall discuss the tax rates of different categories of taxpayers below:

11.4.1 Individuals

From AY 2021-22, individual taxpayers can choose between two tax regimes. The New Tax Regime (Section 115BAC) offers lower slab rates but disallows most exemptions and deductions. From AY 2024-25, the New Regime is the default — taxpayers must actively opt for the Old Regime if they want to avail its deductions.

Old Tax Regime — Tax Slabs (AY 2026-27)

Income Slab	Below 60 years	Senior Citizen (60–79 yrs)	Super Senior (80+ yrs)
Up to Rs. 2,50,000	Nil	Nil	Nil
Rs. 2,50,001 – Rs. 3,00,000	5%	Nil	Nil
Rs. 3,00,001 – Rs. 5,00,000	5%	5%	Nil
Rs. 5,00,001 – Rs. 10,00,000	20%	20%	20%
Above Rs. 10,00,000	30%	30%	30%

New Tax Regime — Tax Slabs (AY 2026-27)

Income Slab	Rate (AY 2026-27)
Up to Rs. 4,00,000	Nil
Rs. 4,00,001 – Rs. 8,00,000	5%
Rs. 8,00,001 – Rs. 12,00,000	10%
Rs. 12,00,001 – Rs. 16,00,000	15%
Rs. 16,00,001 – Rs. 20,00,000	20%
Rs. 20,00,001 – Rs. 24,00,000	25%
Above Rs. 24,00,000	30%

11.4.2 HUF

A HUF is taxed as a separate entity, independent of its individual members. Under the Old Tax Regime, a HUF is taxed at the same slab rates as an individual below 60 years of age — with a basic exemption of Rs. 2,50,000. A HUF can also opt for the New Tax Regime under Section 115BAC, with a basic exemption of Rs. 4,00,000.

A HUF can claim deductions under Section 80C (up to Rs. 1,50,000 for life insurance of members, PPF of members, etc.), Section 80D, Section 80G, and other applicable provisions. A HUF cannot claim deductions under Sections 80CCD (NPS), 80U, or 80DD (which are specific to individuals).

11.4.3 Firm

Partnership firms and Limited Liability Partnerships (LLPs) are taxed at a flat rate:

Entity	Tax Rate on Total Income	Remarks
Partnership Firm	30% flat on total income	No basic exemption. Entire income taxed at 30%.

Limited Liability Partnership (LLP)	30% flat on total income	No basic exemption. Same as partnership firm.

Key features of firm/LLP taxation:

- Partners' share of profit from a firm is fully exempt from tax in the partners' hands under Section 10(2A) — since the firm has already paid tax on it at 30%.
- Remuneration paid to working partners and interest on partners' capital (within limits under Section 40(b)) is deductible from the firm's income but taxable as business income in the partners' hands.
- Surcharge: 12% if total income exceeds Rs. 1 crore. Marginal relief applies.
- Health and Education Cess: 4% on tax + surcharge.

11.4.4 Company

Companies are taxed under one of two regimes — the regular regime or the concessional regime introduced by the Taxation Laws (Amendment) Ordinance, 2019:

Category of Company	**Tax Rate**	**Conditions / Remarks**
Domestic company — Regular regime (turnover > Rs. 400 crore in PY 2021-22)	30%	Eligible for all deductions and exemptions. MAT at 15% applies.
Domestic company — Regular regime (turnover ≤ Rs. 400 crore in PY 2021-22)	25%	Reduced rate for smaller companies. MAT at 15% applies.
Domestic company — Section 115BAA (existing companies opting for new regime)	22%	Cannot claim most deductions/exemptions (e.g., 80IA, 80IC). No MAT.
New domestic manufacturing company — Section 115BAB (incorporated on or after 01.10.2019, commences production by 31.03.2024)	15%	Cannot claim most deductions. No MAT. Extremely attractive for new manufacturers.

Foreign Company	40%	On income attributable to India. Specific royalty/FTS rates may apply under DTAA.

CHECK YOUR PROGRESS

Q 1: Which part and schedule of the Finance Act specifies the rates of taxes applicable for relevant assessment year?

Q 2: State a point of difference between the New Tax Regime and the Old Tax Regime.

11.5 Surcharge

Surcharge is an additional levy on the income tax (not on income) payable by certain taxpayers whose income exceeds prescribed thresholds. It is meant to ensure that the highest income earners contribute a greater proportion of their income as tax. Surcharge rates for individuals and HUFs are as follows:

Total Income Range	**Surcharge Rate (Old Regime)**	**Surcharge Rate (New Regime)**
Up to Rs. 50,00,000	Nil	Nil
Rs. 50,00,001 to Rs. 1,00,00,000	10%	10%
Rs. 1,00,00,001 to Rs. 2,00,00,000	15%	15%
Rs. 2,00,00,001 to Rs. 5,00,00,000	25%	25%
Above Rs. 5,00,00,000	37%	25% (capped — Finance Act 2023 reduced max surcharge under New Regime to 25%)

Surcharge on Companies:

Total Income Range	Domestic Company Surcharge	Foreign Company Surcharge
Up to Rs. 1 crore	Nil	Nil
Rs. 1 crore to Rs. 10 crore	7%	2%
Above Rs. 10 crore	12%	5%

11.6 Health and Education cess

Health and Education Cess is levied at 4% on the amount of income tax plus surcharge (after applying marginal relief, if any) payable by the assessee. It applies to all categories of taxpayers — individuals, HUFs, firms, companies, and others — without exception.

The cess was revised from 3% (Education Cess + Secondary and Higher Education Cess) to 4% (Health and Education Cess) from AY 2019-20. The proceeds go towards funding elementary education and health initiatives.

Health and Education Cess is computed after surcharge and marginal relief on surcharge but before the rebate under Section 87A or relief under Section 89 are applied at the final stage.

11.7 Rebate u/s 87A

Section 87A provides a rebate (a direct reduction of tax payable) to resident individual taxpayers whose Total Income does not exceed the specified threshold. Unlike a deduction (which reduces income), a rebate directly reduces the tax computed on income. The rebate cannot exceed the tax payable — if tax is less than the maximum rebate, the rebate equals the tax (bringing tax to nil).

Assessment Year	Tax Regime	Eligible if TI ≤	Maximum Rebate
AY 2024-25	Old Regime	Rs. 5,00,000	Rs. 12,500
AY 2024-25	New Regime	Rs. 7,00,000	Rs. 25,000
AY 2025-26	Old Regime	Rs. 5,00,000	Rs. 12,500
AY 2025-26	New Regime	Rs. 12,00,000	Rs. 60,000 (full tax

			on Rs. 12L is NIL)

Important conditions for Section 87A rebate:

- Available only to Resident Individuals — not to HUFs, firms, companies, or non-residents.
- Based on Total Income (after Chapter VI-A deductions), not Gross Total Income.
- The rebate is the lower of: the actual tax computed, or the maximum rebate amount.
- The rebate is applied before computing surcharge (i.e., surcharge is on the tax before rebate, but the rebate reduces the post-surcharge tax in the final computation). In practice, if tax after rebate = Nil, surcharge = Nil too.

From AY 2024-25 (New Regime), special rate incomes (LTCG u/s 112A, STCG u/s 111A) do not qualify for the Section 87A rebate. Only the tax on income taxed at normal slab rates qualifies.

ANSWERS TO CHECK YOUR PROGRESS

Q No. 3:What do you mean by Health and Education Cess?

Q No. 4: State two conditions for availing Rebate u/s 87A.

11.8 Relief u/s 89

When salary is received in arrears (relating to past years) or in advance (for future years), the entire amount is taxed in the year of receipt, often pushing the taxpayer into a higher tax bracket — a phenomenon called 'income bunching'. Section 89(1) provides a relief to mitigate this unfair bunching effect, ensuring the taxpayer is not disadvantaged merely due to the timing of payments.

Eligibility for claiming Section 89 Relief

- Any individual receiving salary in arrears or in advance.
- Any individual receiving gratuity, pension, commuted pension, leave encashment, or VRS compensation — in respect of which the taxable amount relates to multiple years.
- It is not available on capital gains, business income, or other non-salary receipts.

11.9 Marginal Relief

Marginal relief is a built-in correction mechanism in income tax law that addresses an anomaly arising from the application of surcharge (and, in certain cases, the withdrawal of the Section 87A rebate). The anomaly: if surcharge is applied mechanically, a taxpayer whose income marginally exceeds a threshold may end up paying significantly more tax than a taxpayer whose income is just below the threshold — which is economically irrational and unfair.

Marginal Relief on Surcharge

Marginal relief ensures that the additional tax payable (including surcharge) due to the income exceeding a threshold does not exceed the incremental income that caused the income to cross that threshold.

Formula for Marginal Relief on Surcharge:

Marginal Relief = (Tax + Surcharge on Actual Income) − [(Tax on Threshold Income) + (Actual Income − Threshold Income)]

The surcharge is then reduced by the Marginal Relief amount (but cannot become negative).

11.10 Practical Problems

Problem 1:

Mr. Arun Bora has a total income of Rs. 16,00,000 for P.Y.2025-26, comprising of income from house property and interest on fixed deposits. Compute his tax liability for A.Y.2026-27 assuming his age is –

(a)45 years

(b) 64 years

(c) 83 years

Assume that Mr. Arun Bora has exercised the option to shift out/ opt out of the default tax regime.

Solution 1:

(a) Computation of Tax liability of Mr. Arun Bora (aged 45 years)

Tax liability:
First Rs. 2,50,000 - Nil
NextRs. 2,50,001 – Rs. 5,00,000- @5% of Rs. 2,50,000 -

Rs. 12,500 Next Rs. 5,00,001 – Rs. 10,00,000- @20% of Rs. 5,00,000 Rs. 1,00,000 Balance (Rs. 16,00,000 -Rs. 10,00,000) - @30% of Rs. 6,00,000Rs. 1,80,000

Rs. 2,92,500

Add: Health and Education cess@4% Rs. 11,700

Rs. 3,04,200

(b) Computation of Tax liability of Mr. Arun Bora (aged 64 years)

Tax liability:
First Rs.3,00,000 - Nil
NextRs. 3,00,001 – Rs. 5,00,000- @5% of Rs. 2,00,000 - Rs. 10,000 Next Rs. 5,00,001 – Rs. 10,00,000- @20% of Rs. 5,00,000 Rs. 1,00,000 Balance (Rs. 16,00,000 -Rs. 10,00,000) - @30% of Rs. 6,00,000Rs. 1,80,000

Rs. 2,90,000

Add: Health and Education cess@4% Rs. 11,600

Rs. 3,01,600

(c) Computation of Tax liability of Mr. Arun Bora (aged 83 years)

Tax liability:
First Rs.5,00,000 - Nil
Next Rs. 5,00,001 – Rs. 10,00,000- @20% of Rs. 5,00,000 Rs. 1,00,000 Balance (Rs. 16,00,000 -Rs. 10,00,000) - @30% of Rs. 6,00,000Rs. 1,80,000

Rs. 2,80,000

Add: Health and Education cess@4% Rs. 11,200

Rs. 2,91,200

Problem 2:

Kiron Devi, a resident of Jorhat, Assam, aged 51 years, furnishes the following information for the year ended on 31-03-2026:

Particulars	Amount (Rs.)
Salary (Gross)	2,75,000
Income from let out house property	(2,85,000)

Interest on loan paid for self-occupied house property	1,20,000
Income from sale of rubber products from rubber plants	2,00,000
Business income - Retail business	1,20,000
Business income - wholesale business	(1,00,000)
Brought forward business loss (A.Y. 2023-24)	(1,35,000)
Long term capital gain from sale of listed equity shares (STT paid on sale and purchase of shares)	2,00,000
Short-term capital gains on sale of shares	(1,10,000)
Lottery winnings (gross)	45,000
Contribution to provident fund and NSC	1,50,000
Income of minor son Raju from special talent	1,50,000
Interest from Bank received by Raju on deposit made out of his special talent	10,000

Compute Kiron's total income under the default tax regime under section 115BAC for the A.Y. 2026-27 assuming Kiron's income is higher than of her husband.

Solution 2:

Computation of total income of Mrs. Kiron Devi for A.Y.2026-27

Particulars	Rs.	Rs.
Salary		
Gross salary	2,75,000	
Less: Standard deduction under section 16(ia)	75,000	2,00,000
Income from house property		
Interest on loan paid for self occupied house property [Not allowable under section 115BAC]	-	
Loss from let out house property	2,85,000	
[Loss from house property is not allowed to be set off against income under any other head nor carried forward while computing income under section 115BAC.]	2,85,000	

Profits and gains from business and profession		
Income from sale of rubber products from rubber plants [Rs. 70,000 (35% of ` 2,00,000) is business income and Rs. 1,30,000 (65% of Rs. 2,00,000) is agricultural income which is exempt from tax]	70,000	
Business Income - Retail business	1,20,000	
	1,90,000	
Less: Set-off of wholesale business loss of Rs. 1,00,000	1,00,000	
	90,000	
Less: Set-off of brought forward business loss of Rs. 1,35,000 of A.Y.2023-24 allowable to the extent of Rs. 90,000 by virtue of section 72(1)	90,000	Nil
[Balance brought forward business loss of Rs. 45,000 (i.e., Rs. 1,35,000 – Rs. 90,000) to be carry forward to A.Y. 2027-28 for set-off against business income of that year]		
Capital Gains		
Long-term capital gain on sale of listed equity shares on which STT is paid	2,00,000	
Less: Set-off of short term capital loss of Rs. 1,10,000	1,10,000	90,000
Income from Other Sources		
Dividend from Indian companies [13,500/90 x 100]	15,000	
Lottery winnings	45,000	
Income of minor son from special talent [Not included in Kiron's income since it is earned from special talent]	-	
Interest from bank received by minor son on deposit made out of his income from special talent [Includible in the income of Mrs. Kiron, since her income is higher than of her husband]	10,000	
Less: Exemption under section 10(32) [Not allowable under section 115BAC]	-	70,000
Gross Total Income		**3,60,000**
Less: Deduction under section 80C [Not allowable under section 115BAC		-
Total Income		**3,60,000**

Problem 3:

Mr. Shashanka (aged 67 years) is retired from a Public Sector Undertaking. He resides in Majuli. He provides you the following particulars of his income and certain payments/investments for the previous year 2025-26:

Pension income of Rs. 7,80,000

Interest from fixed deposits of Rs. 2,35,000 (Gross)

Life insurance premium paid by cheque Rs. 25,500 for insurance of his life. The insurance policy was taken on 08-09-2020 and the sum assured is Rs. 2,50,000.

Premium of Rs. 36,000 paid by cheque for health insurance of self and his wife, who is also a senior citizen.

Rs. 3,500 paid in cash for his health check-up and Rs. 4,500 paid through cheque for preventive health check-up of his mother aged 90 years.

Paid interest of Rs. 9,500 on loan taken from bank for MBA course pursued by his daughter.

A sum of Rs. 95,000 donated by cheque to an institution approved for the purpose of section 80G for promoting family planning.

Rs. 20,000 contributed towards PM CARES Fund by cheque.

Compute the total income of Mr. Shashanka for the assessment year 2026-27 under optional tax regime.

Solution 3:

Computation of total income of Mr. Shashanka for A.Y.2026-27

Particulars	`	`	`
Income under the head "Salaries"			
Pension		7,80,000	
Less: Standard deduction u/s 16(ia)			
Lower of Rs. 50,000 or actual salary/pension		50,000	7,30,000
Income from Other Sources			
Interest from bank on fixed deposit (Gross)			2,35,000
Gross Total Income			**9,65,000**
Less: Deduction under Chapter VI-A			
Deduction under section 80C			

LIC premium of Rs. 25,500 (restricted to 10% of Rs. 2,50,000, being the sum assured, as the policy is taken after 31.3.2012)			
Deduction under section 80D		25,000	
Premium for health insurance for self andhis wife paid by cheque, allowed upto Rs. 50,000 since Mr. Shashanka is a senior citizen	36,000		
Preventive health check-up for self, Rs. 3,500, and for his mother, Rs. 4,500, restricted toRs. 5,000 (deduction allowed even if the same is paid in cash)	5,000		
		41,000	
Deduction under section 80E			
Interest on loan taken from bank for MBA course pursued by his daughter		9,500	
Deduction under section 80G			
Donation to PM CARES Fund – 100% allowable		20,000	
Donation to an approved institution for promoting family planning – 100% allowable subject to qualifying limit of Rs. 83,950 i.e., 10% of Rs. 8,39,500 being the adjusted total income		83,950	
Deduction under section 80TTB			
Interest on fixed deposit with bank allowable as deduction uptoRs. 50,000, since Mr. Shashanka is a senior citizen		50,000	
Total Income			**7,35,550**

Problem 4:

Compute the tax liability of Mr. Khargharia (aged 42), having total income of Rs. 51 lakhs for the Assessment Year 2026-27. Assume that his total income comprises of salary income, Income fromhousepropertyandinterestonfixeddeposit.AssumethatMr. Ahasexercisedtheoption to shift out of section 115BAC.

Solution:

ComputationoftaxliabilityofMr.KharghariafortheA.Y.2026-27

(A)	Income-tax(includingsurcharge)computedontotalincomeofRs.51,00,000		
	Rs.2,50,000–Rs.5,00,000 @5%	Rs.12,500	
	Rs.5,00,001–Rs.10,00,000 @20%	Rs.1,00,000	
	Rs.10,00,001–Rs.51,00,000 @30%	Rs.12,30,000	
	Total	Rs.13,42,500	
	*Add:*Surcharge@10%	Rs. 1,34,250	
			Rs.14,76,750
(B)	Income-taxcomputedontotalincomeofRs.50lakhs (Rs. 12,500 plus Rs. 1,00,000 plus Rs. 12,00,000)		Rs.13,12,500
(C)	TotalIncomeLessRs.50lakhs		Rs.1,00,000
(D)	Income-taxcomputedontotalincomeofRs.50lakhs*plus* theexcessoftotalincomeoverRs.50lakhs(B+C)		Rs.14,12,500
(E)	**Taxliability:lowerof(A)and(D)**		Rs.14,12,500
	*Add:*Healthandeducationcess@4%		Rs.56,500
	Taxliability(includingcess)		**Rs.14,69,000**
(F)	**MarginalRelief(A–D)**		**Rs.64,250**

Alternativemethod-

(A)	Income-tax(includingsurcharge)computedontotalincomeofRs.51,00,000		
	Rs.2,50,000–Rs.5,00,000@5%	Rs.12,500	
	Rs.5,00,001–Rs.10,00,000@20%	Rs.1,00,000	
	Rs.10,00,001–Rs.51,00,000@30%	Rs.12,30,000	
	Total	Rs.13,42,500	
	Add: Surcharge@10%	Rs. 1,34,250	
			Rs.14,76,750
(B)	Income-taxcomputedontotalincomeofRs.50lakhs (Rs. 12,500 plus Rs. 1,00,000 plus Rs. 12,00,000)		Rs.13,12,500
(C)	Excesstaxpayable(A)-(B)		Rs.1,64,250
(D)	**MarginalRelief**(Rs.1,64,250–Rs.1,00,000,beingtheamount of income in excess of Rs. 50,00,000)		**Rs.64,250**
(E)	Taxliability(A)-(D)		Rs.14,12,500
	Add:Healthandeducationcess@4%		Rs.56,500
	Taxliability(includingcess)		**Rs.14,69,000**

Problem 5:

Compute the tax liability of Mr. Deka (aged 65) in a most beneficial manner. He is having total

income of Rs. 5,01,00,000 for the Assessment Year 2026-27. Assume that his total income comprises of salary income, Income from house property and interest on fixed deposit and is the same under both tax regimes.

Solution 5:

ComputationoftaxliabilityofMr.Dekaunderdefaulttaxregime for theA.Y. 2026-27

Income-tax(includingsurcharge)computedontotalincomeofRs.5,01,00,000

Rs.4,00,000–Rs.8,00,000@5%		Rs.20,000
Rs.8,00,001–Rs.12,00,000@10%		Rs.40,000
Rs.12,00,001 –Rs.16,00,000@15%		Rs.60,000
Rs.16,00,001 –Rs.20,00,000@20%		Rs.80,000
Rs.20,00,001 –Rs.24,00,000@25%		Rs.1,00,000
Rs.24,00,001 –Rs.5,01,00,000@30%		Rs.1,43,10,000
Total Rs.1,46,10,000		
	Add: Surcharge@25%	Rs. 36,52,500
	Rs.1,82,62,500	
	*Add:*Healthandeducationcess@4%	Rs.7,30,500
Tax liability		**Rs.1,89,93,000**

ComputationoftaxliabilityofMr.Dekaunderoptionaltaxregime for the A.Y. 2026-27

(A) Income-tax(includingsurcharge)computedontotalincomeofRs.5,01,00,000

Rs.3,00,000–Rs.5,00,000 @5%Rs.10,000		
Rs.5,00,001–Rs.10,00,000 @20%Rs.1,00,000		
Rs.10,00,001–Rs.5,01,00,000@30%Rs. 1,47,30,000		
TotalRs.1,48,40,000		
*Add:*Surcharge@37%Rs.54,90,800Rs.2,03,30,800		

(B) Income-taxcomputedontotalincomeofRs.5crore

	(Rs.10,000plusRs.1,00,000plusRs. 1,47,00,000)	Rs.1,48,10,000
	Add: Surcharge@25%	Rs.37,02,500

Rs.1,85,12,500

(C)	TotalIncomeLessRs.5crore	Rs.1,00,000
(D)	Income-taxcomputedontotalincomeofRs.5crore*plus*the excessoftotalincomeoverRs.5crore (B+C)	Rs.1,86,12,500
(E)	**Taxliability(A)or(D),whicheverislower**	Rs.1,86,12,500
	*Add:*Healthandeducationcess@4%	Rs.7,44,500
Taxliability(includingcess)		**Rs.1,93,57,000**

(F) MarginalRelief(A–D) Rs.17,18,300

Alternative method:

(A) Income-tax(includingsurcharge)computedontotalincomeofRs.5,01,00,000
Rs.3,00,000–Rs.5,00,000@5%Rs.10,000
Rs.5,00,001–Rs.10,00,000@20%Rs.1,00,000
Rs.10,00,001–Rs.5,01,00,000@30%Rs.1,47,30,000
TotalRs.1,48,40,000
*Add:*Surcharge@37%Rs. 54,90,800 Rs.2,03,30,800

(B) Income-taxcomputedontotalincomeofRs.5crore
[(Rs.10,000plusRs.1,00,000plusRs.1,47,00,000)
*plus*surcharge@25%] Rs.1,85,12,500

(C) Excesstaxpayable(A)-(B) Rs.18,18,300

(D) MarginalRelief(Rs.18,18,300–Rs.1,00,000,beingtheamount
ofincome inexcessofRs.5,00,00,000) **Rs.17,18,300**

(E) Taxliability(A)-(D) Rs.1,86,12,500

*Add:*Healthandeducationcess@4% Rs.7,44,500

Taxliability(includingcess)Rs.1,93,57,000

It is **beneficial** for Mr. Deka to pay tax under **default tax regime** under section 115BAC, **sincehis tax liability would be lower** by Rs. 3,64,000 (Rs. 1,93,57,000 - Rs. 1,89,93,000).

11.11 Let Us Sum Up

In this unit we have discussed the following:

- Tax is computed on Total Income at applicable slab rates for each category of taxpayer — with special rates for STCG (u/s 111A), LTCG (u/s 112, 112A), lottery winnings (u/s 115BB), etc. computed separately and added.
- Individuals and HUFs have a choice between the Old Regime (higher rates, more deductions) and the New Regime (lower rates, fewolution: Computation of income of Mr.DS for the A.Y. 2021-22 Particulars Existing tax regime Rs. Alternative tax regime Rs. Loss from house property (50,000) Blocked Business income 14,50,000 14,50,000 Income from other sources (interest on saving bank account) 21,000 21,000 Gross total income 14,21,000 14,71,000 Less: Deductions Under section 80C (PPF contribution) 1,50,000 Blocked Under section 80TTA (interest on saving bank account) 10.000 Blocked Net income 12,61,000 14,71,000 Tax on net income Income tax 1,90,800 1,80,250 Less: Rebate u/s 87A (not available, net income is > Rs.5,00,000) Nil Nil Tax after rebate under section 87A 1,90,800 1,80,250 Add: Surcharge Nil Nil Income tax and surcharge 1,90,800 1,80,250 Add: Health and education cess@4% 7,632 7,210 Tax liability 1,98,432 1,87,460 Tax liability of Mr.DS is lower under the alternative tax regime.

He may opt for it by uploading the option under section 115BAC(5) for the assessment year 2021-22. Mr.DS has business income. Mr.DS should note that the option once exercised shall apply to subsequent assessment years. However, the option once exercised for any previous year can be withdrawn only once for a previous year (other than the year in which it was exercised).er deductions). From AY 2024-25, New Regime is the default.

- Firms and LLPs pay a flat 30% on total income; companies pay 22% (Section 115BAA), 15% (new manufacturers, Section 115BAB), 25% or 30% under the regular regime, depending on turnover.
- Surcharge is an additional levy on income tax for high-income taxpayers: for individuals, 10% (TI > Rs. 50L), 15% (TI > Rs. 1 Cr), 25% (TI > Rs. 2 Cr), 37% (TI > Rs. 5 Cr — under Old Regime; 25% cap under New Regime). Surcharge on LTCG u/s 112A and STCG u/s 111A is capped at 15%.
- Health and Education Cess at 4% is levied on (income tax + surcharge) for all categories of taxpayers without exception.
- Section 87A provides a rebate to resident individuals — up to Rs. 12,500 (Old Regime, TI ≤ Rs. 5L) and up to Rs. 25,000 (New Regime, TI ≤ Rs. 7L in AY 2024-25; up to Rs. 60,000 for TI ≤ Rs. 12L in AY 2025-26). Special rate incomes do not qualify for the rebate under the New Regime.
- Section 89(1) relief mitigates the bunching effect of arrears and advance salary by allowing the taxpayer to pay tax as if the arrears had been received in the year to which they relate. Form 10E must be filed before the return.
- Marginal relief prevents the perverse outcome where a taxpayer with slightly higher income pays disproportionately more tax due to crossing a surcharge threshold or losing the 87A rebate. It caps the incremental tax to the incremental income.

11.12 Answers to Check Your Progress

Answer to Q No. 1:

Part I of the First Schedule to the Finance Act specifies the rates of tax applicable to the current Assessment Year.

Answer to Q No. 2:

The New Tax Regime (Section 115BAC) offers lower slab rates in comparison to the Old Tax Regime. But the New Tax Regime disallows most exemptions and deductions available under the Old Tax Regime.

Answer to Q No. 3:

Health and Education Cess is levied at 4% on the amount of income tax plus surcharge (after applying marginal relief, if any) payable by the assessee. It applies to all categories of taxpayers — individuals, HUFs, firms, companies, and others — without exception.

Answer to Q No. 4:

Two important conditions for Section 87A rebate:

- Available only to Resident Individuals — not to HUFs, firms, companies, or non-residents.
- The rebate is the lower of: the actual tax computed, or the maximum rebate amount.

11.13 Further Readings

- Singhania, V.K. & Singhania, M. — Students' Guide to Income Tax (Taxmann Publications) — Latest Edition
- Ahuja, G.K. & Gupta, R. — Systematic Approach to Income Tax (Bharat Law House) — Latest Edition
- Income Tax Act, 1961 — Sections 60–64 (Clubbing), 80A–80U (Chapter VI-A), 87A, 89, 115BAC, 288A, 288B — Bare Act
- Union Budget 2025 — Finance Bill 2025 (changes to New Regime slabs and Section 87A rebate): www.indiabudget.gov.in
- Income Tax e-Filing Portal — Form 10E for Section 89 relief, ITR filing: www.incometax.gov.in
- CBDT Circular on TDS on Salary (Form 16 / Form 24Q): www.incometaxindia.gov.in

11.14 Model Questions

Short Answer Questions

1. What is the difference between a 'deduction' and a 'rebate'? Which provisions of the Income Tax Act provide for each?
2. What is surcharge? At what levels of income does surcharge apply to individual taxpayers?
3. What is Health and Education Cess? At what rate is it levied and on whom?
4. Explain the concept of marginal relief with reference to the surcharge applicable on individual taxpayers.
5. What is Section 87A? Who is eligible for this rebate? What is the maximum rebate available under the Old and New Tax Regimes for AY 2026-27?

Long Answer Questions

6. Compare the Old Tax Regime and the New Tax Regime for individual taxpayers. Under what circumstances would the Old Regime be more beneficial? Illustrate with an example.

7. Explain the provisions relating to surcharge for all categories of taxpayers — individuals, HUFs, firms, and companies — for AY 2026-27. What is the cap on surcharge applicable to long-term and short-term capital gains from equity?
8. Write a detailed note on the relief available under Section 89(1) of the Income Tax Act.
9. What is marginal relief? Explain (a) marginal relief on surcharge and (b) marginal relief at the Section 87A threshold, with suitable numerical illustrations.

Practical / Numerical Questions

10. Mr. Vivek Rajbonshi (age 40, resident individual) has the following income:

    Salary (gross) Rs. 9,60,000; HRA exempt Rs. 1,20,000; Standard deduction Rs. 50,000; HP loss (SOP interest) Rs. 2,00,000; LTCG on gold Rs. 1,80,000; Interest on savings bank Rs. 12,000. He invests: Rs. 1,50,000 in ELSS (80C), Rs. 25,000 health insurance (80D), Rs. 50,000 in NPS (80CCD(1B)). Compute his total tax liability under the Old Tax Regime for the AY 2026-27.
11. Ms. Usha Devi (age 25, resident individual) chooses the New Tax Regime for AY 2026-27. Her gross salary is Rs. 14,80,000. She receives no HRA but her employer contributes Rs. 1,20,000 to NPS on her behalf (80CCD(2)). Compute her tax liability after all applicable deductions and rebate.
12. Mr. Rajesh Baruah (resident individual) has Total Income of Rs. 50,80,000 including LTCG on equity MF (u/s 112A) of Rs. 5,00,000. Compute his tax liability for the AY 2026-27 including surcharge and apply marginal relief wherever applicable.
13. M/s Sharma &Bora (a partnership firm, AY 2026-27) has business income of Rs. 1,20,00,000 before deducting partners' remuneration of Rs. 30,00,000 and interest on capital of Rs. 8,00,000 (all within Section 40(b) limits). Compute the firm's tax liability including surcharge and cess.
14. Ms. Arunima Bora (resident individual) received salary arrears of Rs. 4,80,000 in FY 2025-26 relating to FY 2022-23. His total income in AY 2026-27 including arrears is Rs. 12,80,000 (Old Regime). His total income in AY 2023-24 was Rs. 6,50,000 (excluding arrears). Using the Section 89(1) methodology, compute his relief (assume applicable slab rates for Old Regime in both years).

UNIT 12: ASSESSMENT PROCEDURE

UNIT STRUCTURE

12.1 Learning Objectives

12.2 Types of Assessment under the Income Tax Act

12.3 Return of Income

12.4 Tax Identification Numbers and Compliance

12.5 Defective Return

12.6 Practical Implications and Case Studies

12.7 Let Us Sum Up

12.8 Further Readings

12.9 Answer to Check Your Progress

12.10 Model Questions

12.1 LEARNING OBJECTIVES

By the end of this unit, learners will be able to:

- **Understand different types of assessment** Explain the meaning, scope, and procedures of self-assessment, summary assessment, scrutiny assessment, best judgment assessment, and re-assessment under the Income Tax Act.
- **Apply knowledge of return filing** Identify who is required to file a return of income, recognize applicable forms, and describe the process of filing returns.
- **Analyze due dates and compliance requirements** Distinguish between statutory due dates, belated returns, and revised returns, and evaluate the consequences of non-compliance.
- **Explain tax identification systems** Demonstrate the importance and usage of PAN, TAN, and the process of Aadhaar–PAN linking in tax administration.
- **Identify and rectify defective returns** Define a defective return, recognize common errors, and outline the procedure for correction under section 139(9).
- **Develop practical compliance skills** Apply theoretical knowledge to real-life scenarios, ensuring accuracy in filing, adherence to deadlines, and proper documentation for assessments.

12.2 TYPES OF ASSESSMENT UNDER THE INCOME TAX ACT

12.2.1. Self-Assessment (Section 140A)

Self-assessment is the process by which a taxpayer evaluates their own income, calculates the tax liability, and files the return accordingly. It is based on the principle that the responsibility of determining taxable income rests primarily with the taxpayer rather than the tax authorities.

In self-assessment, the Income Tax Department does not initially intervene. Instead, the taxpayer voluntarily complies with tax laws by honestly declaring income and paying taxes due.

- **Concept**: The taxpayer computes total income from all sources, applies relevant deductions and exemptions, and calculates the tax payable.
- **Importance**:
  - Promotes voluntary compliance with tax laws.
  - Reduces administrative burden on tax authorities.
  - Encourages accuracy and accountability in reporting income.
  - Builds trust between taxpayers and the government by shifting responsibility to individuals and businesses.

Role of the Taxpayer in Computing Income and Tax Liability

Under self-assessment, the taxpayer plays a central role in ensuring proper compliance:

- **Income Computation**: Identify and aggregate income from various heads such as salary, business, capital gains, and other sources.
- **Claiming Deductions and Exemptions**: Apply deductions under sections like 80C, 80D, and exemptions available under the law.
- **Tax Calculation**: Compute tax liability based on applicable slab rates, surcharge, and cess.
- **Adjustment of Advance Tax and TDS**: Deduct taxes already paid (advance tax or tax deducted at source) from the total liability.
- **Final Payment**: Pay any balance tax due before filing the return.

This process ensures that the taxpayer takes responsibility for accurate reporting and timely payment of taxes.

Filing Returns Based on Self-Assessment

Once the computation is complete, the taxpayer must file the return of income:

- **Preparation of Return**: Use the prescribed forms (ITR forms) depending on the category of taxpayer.
- **Verification of Details**: Ensure correctness of income, deductions, and taxes paid.

- **Payment of Balance Tax**: Any outstanding liability must be cleared before submission.
- **Submission**: File the return electronically (mandatory for most taxpayers) or physically where permitted.
- **Acknowledgement**: Receive confirmation from the Income Tax Department, which serves as proof of compliance.

12.2.2. Summary Assessment / Intimation (Section 143(1)

Summary assessment, also referred to as **intimation under Section 143(1)** of the Income Tax Act, is the **first stage of return processing** by the Income Tax Department. It is a **computerized, preliminary check** of the return filed by the taxpayer. Unlike scrutiny assessments, this process does not involve detailed examination of accounts or investigation. Its purpose is to ensure that the return is arithmetically correct and consistent with the information available in the department's records.

Scope of Processing

The scope of summary assessment is limited to **basic verifications**. The system automatically checks for:

- **Arithmetical errors**: Mistakes in addition, subtraction, or calculation of income and tax.
- **Incorrect claims**: Deductions or exemptions that are not allowable or are claimed in excess.
- **Mismatches**: Differences between the taxpayer's return and data available with the department, such as:
    - Tax Deducted at Source (TDS) reported by employers or banks.
    - Advance tax or self-assessment tax payments.
    - Information from Annual Information Statement (AIS) or Form 26AS.

No manual intervention is involved at this stage; the entire process is automated.

Intimation to the Taxpayer

After processing the return, the department issues an **intimation under Section 143(1)**. This intimation serves as official communication and may contain one of the following outcomes:

1. **Return accepted as filed**
    - No demand and no refund.
    - Confirms that the return is consistent and error-free.
2. **Refund due**
    - If the tax paid (through TDS, advance tax, or self-assessment) exceeds the actual liability, the excess is refunded to the taxpayer.
3. **Demand for additional tax**

- If discrepancies are found, the intimation specifies the additional tax payable along with interest.

The intimation is sent electronically to the taxpayer's registered email ID and is also available on the income tax portal.

Importance of Summary Assessment

- **Efficiency**: Enables quick processing of millions of returns without manual effort.
- **Transparency**: Provides taxpayers with clear communication about adjustments made.
- **Error Detection**: Identifies mistakes early, reducing chances of disputes later.
- **Revenue Protection**: Ensures that taxes are correctly computed and collected.

Time Limit

The intimation under Section 143(1) must be issued **within nine months from the end of the financial year** in which the return is filed. This ensures timely closure of preliminary assessments. It is a **foundational step in tax administration**. It ensures that returns are processed quickly, errors are corrected, and taxpayers are informed of their status. By relying on automation, the system promotes transparency, reduces administrative burden, and strengthens trust between taxpayers and the government.

12.2.3. Regular (Scrutiny) Assessment (Section 143(3))

Regular assessment, commonly referred to as scrutiny assessment, is a detailed examination of the return of income filed by a taxpayer. Unlike the preliminary processing under Section 143(1), scrutiny assessment involves a comprehensive review of accounts, documents, and explanations provided by the taxpayer. The objective is to ensure that the taxpayer has correctly disclosed income, claimed deductions appropriately, and paid the right amount of tax.

Process of Scrutiny Assessment

1. **Selection of Cases**
   - Not all returns are scrutinized. The Assessing Officer (AO) selects specific cases based on risk parameters, random selection, or information suggesting discrepancies.
   - Selection may be through the Computer Assisted Scrutiny Selection (CASS) system or manual identification in exceptional cases.
2. **Notice to the Taxpayer**
   - Once a case is chosen, the AO issues a notice under Section 143(2) requiring the taxpayer to attend proceedings and produce relevant documents.
   - The notice ensures that the taxpayer is given an opportunity to explain their return.
3. **Detailed Examination**

- The AO examines the return, books of accounts, bank statements, invoices, and other supporting documents.
- Queries may be raised regarding income, expenses, deductions, exemptions, or transactions that appear unusual or inconsistent.
- The taxpayer must respond with evidence and clarifications.

4. **Hearing and Representation**
   - The taxpayer can appear personally or through an authorized representative (such as a chartered accountant).
   - The AO considers all submissions before finalizing the assessment.
5. **Final Order**
   - After examination, the AO passes a final assessment order under Section 143(3).
   - This order determines:
     - The total taxable income of the taxpayer.
     - The tax payable or refund due.
     - Any penalties or interest, if applicable.

Importance of Scrutiny Assessment

- Ensures accuracy: Confirms that income and deductions are reported correctly.
- Prevents tax evasion: Detects concealment of income or false claims.
- Promotes compliance: Encourages taxpayers to maintain proper records and transparency.
- Protects revenue: Safeguards the government's tax base by identifying under-reporting or misreporting.

Regular (scrutiny) assessment under Section 143(3) is a critical mechanism in tax administration. It ensures that taxpayers comply with the law by accurately reporting income and paying the correct taxes. While only a small percentage of returns are selected for scrutiny, the process acts as a deterrent against tax evasion and strengthens the integrity of the taxation system.

12.2.4. Best Judgment Assessment (Section 144)

Best Judgment Assessment refers to the authority given to the **Assessing Officer (AO)** under Section 144 of the Income Tax Act, 1961. It empowers the AO to assess the income of a taxpayer based on his **best judgment** when the taxpayer fails to comply with statutory obligations. The assessment is not arbitrary but must be made fairly, honestly, and on the basis of available material.

Circumstances When Section 144 Applies

The AO can invoke Best Judgment Assessment in the following situations:

- **Failure to file a return**: When the taxpayer does not furnish the return of income within the prescribed time under Section 139(1), or even after being served with a notice under Section 142(1).
- **Non-compliance with notices:** If the taxpayer ignores a notice issued under Section 142(1) (requiring production of accounts/documents) or fails to comply with directions under Section 142(2A) (special audit).
- **Failure to produce information:** When the taxpayer does not respond to a notice under Section 143(2), which calls for evidence or documents to support the return.

Process of Best Judgment Assessment

- The AO collects and examines **available information** such as past records, third-party data, and other relevant material.
- Based on this, the AO makes a **reasonable estimate of income**.
- The assessment must be **fair and judicious**, not arbitrary or vindictive.
- Before passing the order, the AO must give the taxpayer an **opportunity of being heard** (principle of natural justice).

Key Features

- **Discretionary power:** AO uses judgment when taxpayer defaults.
- **Opportunity to be heard:** Taxpayer is given a chance to explain before assessment.
- **Based on available material:** AO relies on records, information, and reasonable estimates.
- **Binding nature:** Once passed, the order is enforceable unless appealed.
- **Not arbitrary:** AO must act fairly, ensuring assessment is logical and defensible.

Objective

The purpose of Section 144 is to **protect revenue interests** by ensuring that taxpayers who fail to comply with statutory requirements are still assessed, preventing tax evasion or avoidance.

12.2.5. Re-Assessment / Income Escaping Assessment (Section 147)

Section 147 of the Income Tax Act, 1961 empowers the **Assessing Officer (AO)** to reopen and reassess an income tax case if he has reason to believe that **income chargeable to tax has escaped assessment**. This provision ensures that taxpayers cannot avoid liability through concealment, omission, or by taking advantage of incomplete information during the original assessment.

Circumstances Leading to Re-Assessment

Re-assessment proceedings may be initiated in the following situations:

- **Concealment of income**: When the taxpayer deliberately hides part of their income to reduce tax liability.
- **Omission or failure to disclose material facts**: If the taxpayer does not provide complete details or fails to furnish necessary documents during the original assessment.
- **New information or evidence**: When fresh material, third-party data, or audit findings come to the notice of the AO after the completion of the original assessment.

Procedure

1. **Reason to believe**: The AO must have valid reasons, supported by material evidence, to conclude that income has escaped assessment. Mere suspicion is not sufficient.
2. **Issue of notice under Section 148**: Before initiating re-assessment, the AO serves a notice to the taxpayer under Section 148, requiring them to file a return of income for the relevant year.
3. **Opportunity to respond**: The taxpayer is given a chance to submit the return and provide explanations or documents.
4. **Conduct of re-assessment**: The AO examines the return, considers the new information, and passes a fresh assessment order under Section 147.

Safeguards

- **Recording of reasons**: The AO must record reasons for reopening the case.
- **Judicial scrutiny**: Courts can examine whether the AO had sufficient grounds to reopen the assessment.
- **Opportunity of being heard**: The taxpayer must be given a fair chance to present their case.

Objective

The purpose of Section 147 is to **protect the integrity of the tax system** by ensuring that no taxable income escapes assessment. It balances the need for revenue collection with safeguards against arbitrary reopening of cases.

12.2.6. Search Assessment (Sections 153A & 153C)

Search Assessment refers to the reassessment of income when a **search or seizure operation** is carried out under Section 132 of the Income Tax Act. These provisions ensure that undisclosed income or assets discovered during such operations are properly taxed. The law empowers the Assessing Officer (AO) to reopen and reassess the income of the taxpayer for specified past years.

Section 153A – Assessment in Case of Search

- **Applicability**: Invoked when a search or seizure is conducted on a taxpayer.

- **Scope**: The AO is required to reassess the income of the taxpayer for **six previous years** immediately preceding the year of search, and in certain cases, even additional years if conditions are met.
- **Process**:
    - The AO issues a notice requiring the taxpayer to furnish returns for those years.
    - All pending assessments for those years automatically abate, and fresh assessments are made.
    - The AO considers both disclosed and undisclosed income, along with evidence found during the search.

Section 153C – Assessment of Income of Other Persons

- **Applicability**: This section applies when documents, books of accounts, or assets seized during a search on one person **belong to another person**.
- **Process**:
    - The AO of the searched person hands over the seized material to the AO of the other person.
    - The AO of that other person then proceeds to reassess their income for the relevant years, similar to the procedure under Section 153A.
- **Objective**: To ensure that undisclosed income of persons indirectly connected with the search is also brought under tax net.

Key Features

- **Comprehensive reassessment**: Covers multiple past years, not just the year of search.
- **Focus on undisclosed income**: Ensures that hidden assets or income are taxed.
- **Wide applicability**: Extends to both the person searched and other persons linked through seized material.
- **Overrides regular assessment**: Fresh assessments replace pending ones for the specified years.

Objective

The purpose of Sections 153A and 153C is to strengthen the tax administration by ensuring that **search operations lead to complete and fair reassessment of income**, preventing tax evasion and bringing hidden wealth into the tax net.

12.2.7. Protective Assessment (Conceptual)

A Protective Assessment is a special type of assessment made by the Assessing Officer (AO) when there is uncertainty about who is the correct person liable to pay tax. It is not expressly defined in the Income Tax Act, 1961, but has been recognized and upheld by courts as a valid mechanism to safeguard the interests of revenue.

Circumstances When Protective Assessment is Made

- **Doubt about correct assessee:** When the AO is unsure whether income belongs to one person or another (for example, in cases of disputed ownership or multiple claimants).
- **Pending clarification or litigation:** If the matter is under dispute and final determination of liability is awaited, the AO may make a protective assessment to ensure tax recovery is not jeopardized.
- **Revenue protection:** It acts as a precautionary measure so that income does not escape taxation due to technical uncertainties.

Features of Protective Assessment

- **Not defined in statute:** It is a judicially recognized concept, not explicitly mentioned in the Income Tax Act.
- **Temporary safeguard:** It protects revenue until the correct assessee is identified.
- **Parallel assessment:** Often made alongside a substantive assessment on another person, so that one of them can be enforced once liability is clarified.
- **Court recognition:** Indian courts have upheld the validity of protective assessments to prevent tax evasion.

Objective

The main purpose of a protective assessment is to secure the interests of the revenue by ensuring that tax is not lost due to disputes over liability.Once the correct person is determined, the protective assessment against the other party becomes infructuous.

12.2.8. Block Assessment *(Historical Concept)*

Block Assessment was a special procedure under the Income Tax Act that dealt with **undisclosed income detected during search and seizure operations**. It was introduced to ensure that hidden income discovered in such searches could be taxed in a consolidated manner, covering multiple years at once.

This concept was part of the earlier law and has now been replaced by the current provisions under Sections 153A and 153C. Today, it holds **academic relevance** for understanding the evolution of search assessments in India.

Key Features of Block Assessment

- **Applied to undisclosed income**: Specifically, targeted income or assets found during search operations under Section 132.
- **Block period**: Covered a span of **10 previous years plus the year of search**, instead of assessing each year separately.
- **Single consolidated assessment**: All undisclosed income for the block period was assessed together in one order.

- **Special tax rate**: Such income was taxed at a flat rate (earlier 60%), irrespective of regular slab rates.
- **Focus on evidence from search**: Relied heavily on documents, assets, and information seized during the search.

Objective

The purpose of Block Assessment was to provide a **speedy and effective mechanism** to tax undisclosed income unearthed during searches, without disturbing regular assessments for those years. It simplified the process by consolidating multiple years into a single block.

Current Status

- Block Assessment has been **phased out** and replaced by the **search assessment provisions under Sections 153A and 153C**.
- It is now of **academic importance**, useful for students and professionals to understand how tax law evolved in dealing with search-related undisclosed income.

In short, **Block Assessment** was a historical mechanism designed to tax undisclosed income found during searches in a consolidated manner, but today it serves mainly as a reference point in tax law studies.

12.3 RETURN ON INCOME

A **Return of Income** is a formal statement submitted by a taxpayer to the Income Tax Department declaring their total income, deductions, and tax liability for a particular financial year. It acts as a self-assessment tool, where the taxpayer voluntarily discloses income earned from various sources and computes the tax payable according to the provisions of the Income Tax Act, 1961.

Purpose of Filing Return of Income

- **Compliance with law**: Filing a return is a statutory obligation for individuals and entities whose income exceeds the prescribed threshold.
- **Transparency**: It ensures that the taxpayer's financial dealings are disclosed to the authorities.
- **Claiming benefits**: Returns are necessary to claim refunds, carry forward losses, or avail deductions.
- **Proof of income**: Filed returns serve as documentary evidence of income for purposes like loans, visas, or financial transactions.

Types of Returns

- **Voluntary Return**: Filed by taxpayers even if their income is below the taxable limit, often for record purposes.
- **Mandatory Return**: Required when income exceeds the basic exemption limit or when specific conditions under the Act apply.
- **Revised Return**: Filed to correct errors or omissions in the original return.
- **Belated Return**: Filed after the due date but within the permissible time frame.

Due Dates for Filing

The Income Tax Act prescribes different due dates depending on the category of taxpayer:

- **Individuals and non-audit cases**: Generally, 31st July of the assessment year.
- **Companies and audit cases**: 31st October of the assessment year.
- **Cases requiring transfer pricing report**: 30th November of the assessment year.

Procedure

1. **Preparation of return**: Taxpayer compiles details of income, deductions, and tax liability.
2. **Submission**: Return is filed electronically through the Income Tax Department's portal.
3. **Verification**: The return must be verified either electronically (e-verification) or physically (by sending signed ITR-V).
4. **Processing**: The department processes the return, issues intimation under Section 143(1), and refunds if applicable.

Importance of Filing Return or Consequences of Non-Filing of Return

- **Legal obligation**: Non-filing may attract penalties and prosecution.
- **Financial credibility**: Returns act as proof of income for various financial dealings.
- **Loss carry forward**: Filing within due dates allows taxpayers to carry forward business or capital losses.
- **Refund claims**: Excess tax deducted at source (TDS) can only be refunded through a filed return.

Objective

The overall objective of filing a Return of Income is to ensure **voluntary compliance, accurate tax collection, and transparency in financial reporting**, thereby strengthening the tax administration system. As such **Return of Income** is not just a legal requirement but also a vital financial document that reflects a taxpayer's honesty, compliance, and credibility in the economic system.

12.4TAX IDENTIFICATION NUMBERS AND COMPLIANCE

Tax Identification Numbers (TINs) are unique codes issued by governments to individuals and entities for the purpose of tracking tax obligations. They form the backbone of modern tax administration, ensuring that every taxpayer is properly identified and their financial activities are monitored for compliance.

Purpose of TINs

- **Identification**: Provides a standardized way to recognize taxpayers in official records.
- **Transparency**: Links financial transactions to a verified identity, reducing fraud and evasion.
- **Efficiency**: Simplifies filing returns, paying taxes, and accessing government services.
- **Global Relevance**: Used in cross-border trade and financial reporting to comply with international standards.

Types of Tax Identification Numbers

Different countries use different systems, but the principle remains the same: a unique identifier for tax purposes.

Country	Common TIN Types	Usage
India	PAN (Permanent Account Number), GSTIN (Goods and Services Tax Identification Number)	PAN for income tax, GSTIN for indirect tax compliance
United States	SSN (Social Security Number), EIN (Employer Identification Number), ITIN (Individual Taxpayer Identification Number)	SSN for individuals, EIN for businesses, ITIN for non-residents
European Union	VAT Identification Number	Used for cross-border trade and VAT compliance

Compliance Requirements

- **Mandatory Use**: TIN must be quoted in tax returns, invoices, and official financial documents.
- **Accurate Reporting**: Taxpayers must ensure that income, expenses, and deductions are correctly linked to their TIN.

- **Record Keeping**: Authorities use TINs to maintain databases of taxpayers and detect irregularities.
- **Penalties for Non-Compliance**:
    - Fines for failing to register or misuse of TIN.
    - Audits and investigations for suspicious activity.
    - Legal consequences, including prosecution, in cases of deliberate fraud.

Importance of Compliance

- **Legal Obligation**: Compliance ensures adherence to national tax laws.
- **Financial Integrity**: Builds trust between taxpayers and authorities.
- **Public Revenue**: Taxes collected through proper compliance fund infrastructure, healthcare, education, and welfare.
- **International Cooperation**

12.5DEFECTIVE RETURN

Defective Return arises when the Income Tax Department finds that a filed Income Tax Return (ITR) is incomplete, inconsistent, or contains mismatched information. To safeguard compliance, the department issues a **Defective Return Notice under Section 139(9)**, giving taxpayers an opportunity to rectify mistakes.

Meaning of Defective Return

- A return is considered defective if it lacks essential details or contains errors that prevent proper assessment.
- Common issues include:
    - Missing mandatory information in schedules.
    - Mismatch between TDS (Tax Deducted at Source) and reported income.
    - Incorrect personal or financial details.
    - Unreported sources of income.
    - Incomplete filing of annexures or statements.

Causes of Defective Return

- **Incomplete ITR filing** – leaving mandatory fields blank.
- **Mismatch in tax credits** – differences between Form 26AS and reported TDS.
- **Incorrect computation** – errors in income or deduction calculations.
- **Missing documents** – failure to attach required statements or proofs.
- **Wrong PAN or identity details** – leading to invalid identification.

Compliance Process

When a return is flagged as defective:

1. **Notice Issued**: Taxpayer receives a notice under Section 139(9) via email or post.
2. **Response Timeline**: Taxpayer must correct and re-submit the return within the specified period (usually 15 days, extendable).
3. **Correction Options**:
    - File a **revised return** correcting the defects.
    - Provide clarification if the return is actually valid.
4. **Final Outcome**:
    - If corrected, the return is treated as valid.
    - If ignored, the return is treated as **invalid**, as if it was never filed.

Importance of Compliance

- **Avoid Penalties**: Timely correction prevents fines and interest charges.
- **Ensure Refunds**: Refund claims are processed only if the return is valid.
- **Maintain Records**: A valid return ensures proper documentation for future assessments.
- **Legal Protection**: Compliance shields taxpayers from litigation or scrutiny.

12.6PRACTICAL IMPLICATIONS AND CASE STUDIES

TAX COMPLIANCE JOURNEY OF XYZ ENTERPRISES

XYZ Enterprises is a mid-sized trading company in India. During the financial year, it earned income from domestic sales and international exports. The company filed its Return of Income (ROI) using its Permanent Account Number (PAN) and GSTIN for indirect tax compliance.

1. Return of Income

XYZ filed its ROI declaring profits and claimed deductions under business expenses. The return was submitted before the due date, ensuring eligibility for refunds and avoiding late fees.

Practical Implication: Filing ROI on time allowed the company to use the return as proof of income while applying for a bank loan.

2. Tax Identification Numbers and Compliance

The company used its PAN for income tax filings and GSTIN for claiming input tax credits. During routine checks, authorities matched invoices with GSTIN records.

Case Highlight: Some mismatches were found in supplier invoices, leading to reversal of credits. This reinforced the importance of accurate compliance linked to TINs.

3. Types of Assessment

- Self-Assessment: XYZ calculated tax liability and paid advance tax before filing ROI.
- Summary Assessment (143(1)): The system flagged minor mismatches between TDS reported in Form 26AS and the ROI.
- Scrutiny Assessment (143(3)): Authorities selected XYZ for detailed review due to high export turnover. Books of accounts were examined, and additional income was discovered from foreign exchange gains.
- Best Judgment Assessment (144): Not applicable here, but serves as a reminder that non-cooperation could have led to estimated assessments.
- Reassessment (147): Later, authorities reopened the case when new information showed under-reported commission income.

Practical Implication: Multiple layers of assessment ensured transparency and prevented revenue leakage.

4. Defective Return

Initially, XYZ's ROI was marked defective under Section 139(9) because mandatory schedules on depreciation were missing. The company received a notice and corrected the return within 15 days.

Case Highlight: By rectifying the defect promptly, XYZ avoided its return being treated as invalid, ensuring refund processing continued smoothly.

Conclusion

This case study of XYZ Enterprises demonstrates how different aspects of tax law interact in practice:

- Filing ROI establishes financial credibility.
- TINs ensure transparency and accountability.
- Assessments provide checks at multiple levels to detect errors or evasion.
- Defective return notices act as corrective tools rather than punitive measures.

Overall Insight: Accurate reporting, timely compliance, and responsiveness to notices are the keys to maintaining smooth tax operations and avoiding penalties.

12.7LET US SUM UP

- The Income Tax Act provides multiple types of assessments to ensure compliance and revenue protection: self-assessment, summary/intimation, scrutiny, best judgment, reassessment, search, protective, and block assessment.
- Filing a Return of Income (ROI) is both a statutory obligation and a financial necessity, serving as proof of income and enabling refunds, deductions, and loss carry-forward.
- Tax Identification Numbers (TINs) like PAN and GSTIN in India are critical for linking transactions, ensuring transparency, and preventing evasion.
- A Defective Return under Section 139(9) highlights errors or omissions in filing, giving taxpayers a chance to correct them.
- Practical case studies (e.g., XYZ Enterprises) show how compliance, timely filing, and responsiveness to notices safeguard credibility and prevent penalties.
- Overall, the assessment procedure balances voluntary compliance with checks by authorities, ensuring fairness, accuracy, and trust in the tax system.

12.8FURTHER READING

- Income Tax Act, 1961 (Bare Act with latest amendments).
- Ahuja, Girish & Gupta, Ravi: *Systematic Approach to Income Tax*.
- Singhania, Vinod K.: *Direct Taxes Law & Practice*.
- ICAI publications on Direct Tax laws and compliance.

12.9ANSWERS TO CHECK YOUR PROGRESS

1. **Self-Assessment** means taxpayers compute their own income and tax liability before filing returns (Section 140A).
2. **Summary Assessment (143(1))** is an automated preliminary check of returns for arithmetical errors, mismatches, or incorrect claims.
3. **Scrutiny Assessment (143(3))** involves detailed examination of accounts and documents to verify correctness of income and deductions.
4. **Best Judgment Assessment (144)** applies when taxpayers fail to file returns or comply with notices, allowing AO to estimate income.
5. **Reassessment (147)** is initiated when income has escaped assessment due to concealment, omission, or new information.
6. **Defective Return (139(9))** is one that contains errors or omissions; taxpayers must rectify within the prescribed time.
7. **TINs** like PAN and GSTIN are mandatory identifiers ensuring compliance and transparency in tax administration.

12.10MODEL QUESTIONS

Short Answer Questions

1. Define self-assessment under Section 140A.
2. What is meant by intimation under Section 143(1)?
3. Explain the concept of a defective return.
4. List the types of Tax Identification Numbers used in India.
5. What is a protective assessment?

Long Answer Questions

1. Discuss the process and importance of scrutiny assessment under Section 143(3).
2. Explain the circumstances under which best judgment assessment can be invoked.
3. Describe the procedure of reassessment under Section 147 and safeguards available to taxpayers.
4. Evaluate the role of Tax Identification Numbers in ensuring compliance and transparency.
5. Using the case study of XYZ Enterprises, analyze the practical implications of different types of assessments.

UNIT 13: TAX DEDUCTED AT SOURCE (TDS), TAX COLLECTED AT SOURCE (TCS), & ADVANCE TAX

UNIT STRUCTURE

13.1 Learning Objectives

13.2 Tax Deducted at Source (TDS)

13.3 Tax Collected at Source (TCS)

13.4 Advance Tax

13.5Broad Rate Structure of TDS and TCS

13.6 Compliance Requirements

13.7 Let Us Sum Up

13.8 Further Readings

13.9 Answers to Check Your Progress

13.10 Model Questions

13.1 LEARNING OBJECTIVES

After studying this unit, the learner will be able to:

- **Understand the concept and purpose** of TDS, TCS, and Advance Tax under the Indian Income-tax system.
- **Explain the applicability** of TDS on various types of payments such as salary, interest, rent, contractual payments, and professional fees.
- **Identify the broad rate structure** of TDS and TCS and understand the factors influencing applicable rates.
- **Describe the compliance requirements** related to deduction, collection, deposit, return filing, and issuance of certificates under TDS and TCS provisions.
- **Differentiate between TDS and TCS** in terms of responsibility, nature of transactions, and point of tax collection.
- **Understand the scope and coverage of TCS**, including goods and transactions on which tax is collected at source.
- **Understand the due dates and installment system** for payment of advance tax during the financial year.

- **Develop the ability to estimate tax liability** for the purpose of advance tax after considering TDS and TCS credits.
- **Understand the consequences of non-compliance**, including interest provisions under Sections 234A, 234B, and 234C of the Income-tax Act.
- **Appreciate the role of TDS, TCS, and Advance Tax** in ensuring regular revenue collection and reducing tax evasion.

13.2 TAX DEDUCTED AT SOURCE (TDS)

13.2.1 Concept & Purpose of TDS

Tax Deducted at Source (TDS) is a system under which tax is deducted by the payer at the time of making specified payments such as salary, interest, rent, professional fees, or contract payments. The deducted tax is then deposited with the Government on behalf of the recipient of income.

The basic idea behind TDS is that tax should be collected **at the very source of income**, rather than waiting until the end of the financial year. The person receiving income gets credit for the tax deducted while filing their return of income.Thus, TDS represents an advance collection of tax linked directly to income-generating transactions.

Purpose of TDS

The introduction of TDS serves several important objectives within the Indian taxation framework:

1. **Early Collection of Tax Revenue**: TDS ensures that tax is collected throughout the year rather than waiting until the assessment stage. This provides the Government with a regular and steady flow of revenue.
2. **Reduction of Tax Evasion**: By deducting tax at the source of income, the possibility of concealment or non-reporting of income is significantly reduced. It creates a transparent trail of income and tax payment.
3. **Widening of the Tax Base**: TDS brings various categories of income earners, such as employees, professionals, contractors, and landlords, into the tax system, thereby expanding the tax base.
4. **Convenience for Taxpayers**: Since tax is deducted in small amounts at the time of payment, it reduces the burden of paying a large lump-sum tax at the end of the year.
5. **Improved Tax Compliance**: The system places responsibility on deductors to comply with tax laws, ensuring better enforcement and accountability in tax administration.
6. **Efficient Monitoring of Income**: TDS facilitates effective monitoring and matching of income details through returns and tax records, improving the overall efficiency of the tax system.

13.2.2Key aspects and applicability of TDS

The provisions of Tax Deducted at Source (TDS) apply to a wide range of payments made during the course of business or employment. Common payments covered under TDS include salary paid to employees, interest on deposits or loans, rent for use of land or buildings, professional or technical fees, payments to contractors or sub-contractors, commission and brokerage, and other specified payments.The objective of covering such payments is to ensure that tax is collected at the time income is generated, thereby improving tax compliance and reducing tax evasion.Threshold Limits for TDS i**s** not required to be deducted on every payment. The Income-tax Act prescribes specific threshold limits for different types of payments. Tax deduction becomes mandatory only when the amount paid or credited exceeds the specified limit during a financial year.These threshold limits help reduce the compliance burden for small payments and ensure that TDS provisions mainly apply to significant income transactions.

TDS is applicable on:

- **TDS on Salary:**TDS on salary is deducted by the employer based on the estimated income of the employee for the entire financial year. While computing taxable salary, the employer considers:
  - Basic salary and allowances
  - Exemptions and deductions claimed by the employee
  - Applicable tax slab rates

The tax is deducted every month in proportion to the annual tax liability, ensuring smooth payment throughout the year.

- **TDS on Interest:** Interest income, such as interest on bank fixed deposits or loans, is subject to TDS when it exceeds the specified limit. Banks and financial institutions deduct tax before paying interest to the depositor.

The objective is to ensure reporting and taxation of interest income, which is otherwise difficult to track.

- **TDS on Contractors:** Payments made to contractors or sub-contractors for carrying out work (including supply of labour) attract TDS. This applies to payments for construction, advertising, transport (subject to conditions), and other contractual work.

TDS ensures tax compliance in sectors where payments are frequent and substantial.

- **TDS on Rent:** Rent paid for the use of land, building, plant, machinery, or equipment is subject to TDS if it exceeds the prescribed annual limit. The responsibility to deduct tax lies with the person making the rent payment.This provision helps in tracking rental income and bringing it into the tax net.

- **TDS on Professional Fees:** Professional fees paid to professionals such as doctors, lawyers, accountants, consultants, and engineers are subject to TDS. The deduction is made

at the time of payment or credit.The provision promotes transparency and compliance among professionals receiving substantial service income.

- **TDS on Commission and Brokerage:** Deduction on payments made to agents or brokers.

- **TDS on Lottery, Games, and Horse Racing Winnings**: TDS is deducted at higher rates on such incomes.

The rates of TDS vary depending on the nature of payment. Some common rates are:

Nature of Payment	Rate of TDS
Salary	As per income tax slab rates
Interest (other than securities)	10% (if PAN is provided)
Contractor payments	1% (individual/HUF), 2% (others)
Rent (above ₹2,40,000 per year)	10%
Professional fees (above ₹30,000 per year)	10%
Commission/Brokerage	5%
Lottery winnings	30%

Note: Rates are subject to periodic changes by the government through Finance Acts.

- **Compliance Requirements**

Compliance with TDS provisions involves several responsibilities for the deductor:

- **Deduction of Tax**: Tax must be deducted at the time of payment or credit, whichever is earlier.
- **Deposit of Tax**: Deducted tax must be deposited with the government within **7 days from the end of the month** in which deduction is made.
- **Quarterly Returns**: Deductors must file quarterly TDS returns in prescribed forms (Form 24Q for salary, Form 26Q for non-salary payments).
- **Issuance of Certificates**: Deductors must issue TDS certificates to deductees:
  - **Form 16** for salary income.
  - **Form 16A** for non-salary payments.
- **PAN Requirement**: If the deductee fails to furnish PAN, higher rates of TDS may apply (usually 20%).

13.3TAX COLLECTED AT SOURCE (TCS)

13.3.1Concept & purpose of TCS

Tax Collected at Source (TCS) refers to the collection of tax by the seller from the buyer at the time of sale of specified goods or execution of certain transactions. The seller collects tax in addition to the sale price and deposits it with the Government.

Unlike TDS, where tax is deducted from income, TCS is collected at the point of sale of certain goods identified under the Income-tax Act.
TCS is applicable mainly to transactions that involve goods or activities where tracking income is difficult and the risk of tax evasion is relatively high.

Purpose of TCS

The purpose of TCS includes the following:

- **Tracking high-risk transactions:** TCS helps monitor transactions involving specific goods or high-value sales.
- **Ensuring reporting of income:** It ensures that income arising from such transactions is brought into the tax system.
- **Preventing tax leakage:** By collecting tax at the source, the chances of revenue loss are reduced.
- **Supporting tax compliance:** It encourages buyers and sellers to maintain proper records and comply with tax laws.

Items Covered under TCS

The Income Tax Act specifies certain goods and transactions where TCS is applicable. These include:

- **Alcoholic liquor for human consumption**
- **Tendu leaves** (used in making bidis)
- **Timber obtained under a forest lease or otherwise**
- **Scrap** (waste and discarded material with no further use except recycling)
- **Minerals** such as coal, lignite, and iron ore
- **Sale of motor vehicles exceeding ₹10 lakh**
- **Overseas tour packages**
- **Foreign remittance under the Liberalized Remittance Scheme (LRS)**

These categories are chosen because they involve significant revenue potential and are prone to tax leakage.

The rates of TCS vary depending on the nature of goods or services. Some common rates are:

Item/Transaction	Rate of TCS
Alcoholic liquor for human consumption	1%
Tendu leaves	5%
Timber (forest lease or otherwise)	2.5%
Scrap	1%
Minerals (coal, lignite, iron ore)	1%
Sale of motor vehicle > ₹10 lakh	1%
Overseas tour packages	5%

Item/Transaction	Rate of TCS
Foreign remittance under LRS	5% (subject to conditions)

Note: Rates are subject to change as per amendments in the Income Tax Act and annual Finance Acts.

Compliance Requirements

Compliance with TCS provisions involves several responsibilities for the seller:

- **Collection of Tax**: The seller must collect tax at the time of debiting the buyer's account or receiving payment, whichever is earlier.
- **Deposit of Tax**: The collected tax must be deposited with the government within **7 days from the end of the month** in which it was collected.
- **Quarterly Returns**: Sellers must file quarterly TCS returns in **Form 27EQ** to report the details of tax collected.
- **Issuance of Certificate**: A certificate of tax collected, known as **Form 27D**, must be issued to the buyer. This enables the buyer to claim credit of the tax collected while filing their income tax return.
- **PAN Requirement**: If the buyer fails to furnish their PAN, a higher rate of TCS may be applicable (usually double the normal rate or 5%, whichever is higher).

13.4ADVANCE TAX

13.4. Concept & purpose of Advance Tax

Advance tax refers to the payment of income tax during the financial year in which the income is earned, instead of paying the entire tax liability at the time of filing the return. It is calculated on the basis of the taxpayer's **estimated income** for the year after considering eligible deductions and credits.Advance tax is generally paid in installments at prescribed intervals.

Purpose of Advance Tax

The purpose of advance tax is as follows:

- **Spreading the tax burden:** It reduces the financial burden of paying a large amount of tax at one time.
- **Ensuring steady revenue flow:** The Government receives tax revenue throughout the year.
- **Encouraging financial discipline:** Taxpayers are required to estimate income and plan their tax payments in advance.
- **Reducing defaults and interest liability:** Timely payment of advance tax helps avoid interest for non-payment or short payment.

Liability for Advance Tax

- **Threshold:** Advance tax becomes applicable if the total tax liability for a financial year exceeds ₹10,000 after adjusting for Tax Deducted at Source (TDS) and Tax Collected at Source (TCS).
- **Applicability:**
  - **Individuals:** Salaried persons may not need to pay advance tax if their liability is fully covered by TDS. However, if they have additional income (like rent, capital gains, or interest), advance tax is applicable.
  - **Businesses and Professionals:** Liable to pay advance tax if their estimated tax liability crosses the threshold.
  - **Presumptive Taxation Scheme (Sec. 44AD/44ADA):** Taxpayers opting for presumptive taxation must pay the entire advance tax liability in one installment by 15th March.

Due Dates for Advance Tax Payments

Advance tax is paid in installments based on estimated liability. The schedule is as follows:

Due Date	Percentage of Total Tax Liability to be Paid
15th June	**15% of total liability**
15th September	**45% of total liability (cumulative)**
15th December	**75% of total liability (cumulative)**
15th March	**100% of total liability**

This schedule applies to all taxpayers except those under presumptive taxation, who pay the full amount by 15th March.

Calculation of Advance Tax

Steps for calculating advance tax:

1. Estimate total income for the financial year (salary, business profits, capital gains, rental income, interest, etc.).
2. Compute tax liability as per applicable slab rates, surcharge, and cess.
3. Deduct TDS/TCS already paid or expected to be deducted.
4. Pay balance liability as advance tax in installments on or before due dates.
5. Revise estimates if income changes during the year and pay additional tax accordingly.

Interest for Defaults (Sections 234A, 234B, 234C)

Failure to comply with advance tax provisions attracts interest under the Income Tax Act:

- **Section 234A – Delay in Filing Return**
  - Interest @1% per month (or part thereof) on tax payable for late filing of income tax return.

- **Section 234B – Short Payment of Advance Tax**
  - Interest @1% per month (or part thereof) if advance tax paid is less than 90% of assessed tax liability.
- **Section 234C – Deferment of Advance Tax Installments**
  - Interest @1% per month for delay or shortfall in payment of installments as per due dates.

These provisions encourage timely compliance and penalize defaults to ensure fairness in tax administration.

13.5 BROAD RATE STRUCTURE OF TDS AND TCS AND FACTORS INFLUENCING APPLICABLE RATES

The rate at which tax is deducted or collected at source plays a crucial role in the effective functioning of the Indian tax system. Both **Tax Deducted at Source (TDS)** and **Tax Collected at Source (TCS)** follow a structured rate mechanism prescribed under the Income-tax Act, 1961. These rates are designed to ensure timely tax collection while maintaining fairness among different categories of taxpayers. Understanding the broad rate structure and the factors that influence the applicable rates helps learners appreciate how source-based taxation operates in practice.

Similarly, under TCS provisions, the seller or specified person is required to **collect tax from the buyer** at the time of sale of specified goods or receipt of consideration. Proper identification of the nature of transaction and applicable rate is essential to ensure correct deduction or collection.

Persons responsible for deducting or collecting tax are required to **file periodic statements or returns** containing details of tax deducted or collected. These returns include information such as the amount paid, tax deducted or collected, and details of the deductee or buyer.Filing accurate and timely returns ensures proper matching of tax credits and enables effective monitoring by the tax authorities.

After depositing tax and filing returns, the deductor or collector must **issue certificates** to the deductee or buyer as proof of tax deducted or collected. These certificates serve as evidence of tax payment and enable the recipient to claim credit while filing the return of income.Issuance of certificates within the prescribed time is essential to maintain transparency and trust in the tax system.

Broad Rate Structure of TDS

Tax Deducted at Source (TDS) is an important mechanism for the collection of income tax at the point where income arises. The rate at which tax is deducted is not uniform for all transactions. Instead, the Income-tax Act, 1961 provides a structured and differentiated rate system to ensure fairness, accuracy, and effective tax administration. This section provides a general overview of how TDS rates are determined and the key factors influencing their application.TDS rates are

payment-specific, meaning the rate of deduction varies depending on the nature of the payment. For example, salary income follows slab-based taxation, whereas payments such as interest, rent, professional fees, or contractual payments are subject to fixed percentage deductions.
In general, TDS rates may be grouped into:

- **Slab-based rates**, mainly applicable to salary income where tax is calculated according to the applicable income-tax slabs.
- **Flat percentage rates**, applicable to most non-salary payments such as interest, professional fees, commission, and contract payments.

The rates are notified through the Finance Act of each year and may be revised to align with current tax policy objectives. The law also provides for **higher rates of deduction** in cases where the recipient fails to furnish Permanent Account Number (PAN), ensuring better reporting and compliance.

Variation of TDS Rates

TDS rates differ based on several statutory and practical considerations. The purpose of having varied rates is to align the deduction of tax with the nature of income and the characteristics of the recipient.

Nature of Payment

One of the most significant factors influencing the TDS rate is the **nature of payment**. Different types of income have different earning patterns and tax implications. For example, salary income is subject to deduction based on applicable income-tax slab rates, whereas payments such as interest, rent, professional fees, commission, or contract payments are generally subject to fixed percentage deductions.This classification ensures that tax is deducted in a manner that broadly reflects the tax liability arising from each category of income.

Status of the Payee

The **status of the payee** also affects the applicable TDS rate. The law recognizes that individuals, firms, companies, and other entities differ in terms of their tax treatment and compliance capacity.In certain cases, the rate may vary depending on whether the payee is a resident or non-resident, or whether the payee is an individual or a corporate entity. This differentiation helps in applying appropriate tax rules to diverse categories of taxpayers.

Availability of Permanent Account Number (PAN)

The furnishing of a **Permanent Account Number (PAN)** by the payee plays a crucial role in determining the TDS rate. PAN enables the Income-tax Department to track income and tax credits accurately.If the payee does not provide PAN, the Income-tax Act mandates deduction of tax at a **higher rate**. This provision acts as a deterrent against non-disclosure of income and encourages taxpayers to comply with identification and reporting requirements.

Prescribed Rates under Tax Laws

TDS rates are **statutorily prescribed** under the Income-tax Act, 1961 and are subject to revision through the **Finance Act of the relevant financial year**. Annual amendments allow the Government to adjust rates in line with economic conditions, revenue needs, and policy objectives.Therefore, deductors are required to apply the rates in force for the relevant year while making deductions.

Objective of a Differentiated Rate Structure

The varied rate structure under TDS aims to:

- Ensure equitable tax collection across different income categories
- Facilitate early and efficient realization of tax revenue
- Reduce tax evasion by linking deductions to identifiable payments
- Promote voluntary compliance through systematic reporting

1.4 Compliance

- Deduction: At the time of payment or credit.
- Deposit: Within 7 days from the end of the month in which deduction is made.
- Return filing: Quarterly TDS returns (Form 24Q for salary, Form 26Q for non-salary).
- Certificates: Form 16 (salary) and Form 16A (non-salary) issued to deductees.

13.5 LET'S SUM UP

- TDS ensures tax is deducted at the source of income (salary, interest, rent, professional fees, contractor payments, etc.), providing steady revenue flow and reducing evasion.
- TCS is collected by sellers at the point of sale of specified goods or services (alcohol, timber, scrap, minerals, motor vehicles, overseas tour packages, foreign remittances), ensuring reporting of high-risk transactions.
- Both TDS and TCS have structured rates, compliance requirements (deduction/collection, deposit, quarterly returns, issuance of certificates), and penalties for defaults.
- Advance tax provisions (Sections 234A, 234B, 234C) impose interest for late filing, short payment, or deferment, encouraging discipline.
- Together, TDS, TCS, and Advance Tax form the backbone of India's tax administration, ensuring transparency, regular revenue, and reduced evasion.
- Together, TDS, TCS, and Advance Tax form the backbone of India's tax administration, ensuring transparency, regular revenue, and reduced evasion.

13.6 FURTHER READINGS

- Income Tax Act, 1961 (Bare Act with latest amendments).

- Ahuja, Girish & Gupta, Ravi: *Systematic Approach to Income Tax*.
- Singhania, Vinod K.: *Direct Taxes Law & Practice*.
- ICAI Study Material on Direct Taxes.

13.7 ANSWERS TO CHECK YOUR PROGRESS

- **TDS** is tax deducted at the source of income by the payer and deposited with the government.
- **TCS** is tax collected by the seller from the buyer at the time of sale of specified goods or services.
- **Advance Tax** refers to tax paid in installments during the financial year based on estimated income.
- Common **TDS rates**: Salary (slab rates), Interest (10%), Rent (10%), Professional fees (10%), Commission (5%), Lottery winnings (30%).
- Common **TCS rates**: Alcohol (1%), Timber (2.5%), Scrap (1%), Motor vehicles > ₹10 lakh (1%), Overseas tour packages (5%).
- **Due dates for Advance Tax**: 15th June (15%), 15th September (45%), 15th December (75%), 15th March (100%).
- **Interest provisions**: Section 234A (late filing), Section 234B (short payment), Section 234C (deferment of installments).

13.8 MODEL QUESTIONS

Short Answer Questions

1. Define Tax Deducted at Source (TDS).
2. What is Tax Collected at Source (TCS)?
3. State the threshold for applicability of advance tax.
4. List any four items covered under TCS provisions.
5. Mention the due dates for advance tax installments.

Long Answer Questions

1. Explain the concept, purpose, and compliance requirements of TDS.
2. Discuss the scope and coverage of TCS, highlighting goods and transactions where it applies.
3. Describe the procedure for calculating and paying advance tax, along with consequences of non-compliance.

4. Compare and contrast TDS and TCS in terms of responsibility, nature of transactions, and point of collection.
5. Analyze the importance of TDS, TCS, and Advance Tax in ensuring transparency and reducing tax evasion in India.

INCOME TAX LAW & PRACTICE

Unit 14: Appeals, Penalties, Prosecution & Recent Developments

UNIT STRUCTURE

14.1 Learning Objectives

14.2 Introduction

14.3 Appeals under the Income Tax Act

14.4 Revision and Rectification

14.5 Penalties under the Income Tax Act

14.6 Prosecution under the Income Tax Act

14.7 Recent Developments in Income Tax

14.8 Check Your Progress

14.9 Let Us Sum Up

14.10Answer Your Progress

14.11 Further Reading

14.12 Model Questions

14.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

• Understand the appellate hierarchy under the Income Tax Act.

• Explain the concept of revision and rectification of orders.

• Identify various penalties applicable under the Income Tax Act.

• Understand provisions relating to prosecution for tax offences.

• Describe recent developments such as faceless assessment and new tax regime.

14.2 INTRODUCTION

The Income Tax Act, 1961 provides a structured framework to ensure fairness, accountability, and transparency in tax administration. Since taxation directly affects the financial rights and obligations of individuals and entities, the law incorporates safeguards to address disputes and correct errors. The provisions relating to appeals, penalties, and prosecution form an essential part of this protective mechanism within the tax system.

Appeals provide taxpayers with a statutory remedy against unjust or incorrect assessment orders, while penalties and prosecution ensure discipline and compliance. Recent developments such as faceless assessment, digital compliance systems, and the introduction of new tax regimes have modernized tax administration, strengthening efficiency, transparency, and taxpayer confidence.

14.3 APPEALS UNDER THE INCOME TAX ACT

The Income Tax Act provides a structured appellate hierarchy to resolve disputes between taxpayers and tax authorities.

The appellate hierarchy consists of four levels:

1. Commissioner of Income Tax (Appeals) – CIT(A)

The Commissioner of Income Tax (Appeals), commonly referred to as CIT(A), is the first appellate authority. An assessee who is dissatisfied with an assessment order, penalty order, or certain other orders passed by the Assessing Officer can file an appeal before the CIT(A).

Key Features:

a) Appeal must generally be filed within 30 days from the date of receipt of the order.
b) CIT(A) has wide powers:

- Confirm the assessment
- Reduce the tax liability
- Enhance the assessment (after giving opportunity of hearing)
- Annul (cancel) the assessment

c) The CIT(A) can admit additional evidence under prescribed conditions.
d) Proceedings now often take place under the Faceless Appeal Scheme, ensuring transparency and reducing personal interface.
e) The CIT(A) examines both facts and legal issues.

2. **Income Tax Appellate Tribunal (ITAT)**

The Income Tax Appellate Tribunal (ITAT) is the second appellate authority and is considered the final fact-finding authority in income tax matters.

Key Features:

a) Appeal to ITAT must be filed within 60 days from receipt of CIT(A)'s order.
b) ITAT benches generally consist of:

- One Judicial Member
- One Accountant Member
- ITAT re-examines facts and law.
- Its decisions are binding on lower authorities unless reversed by a higher court.

Since ITAT is the last authority to examine factual matters, its role is crucial in dispute resolution.

3. High Court

An appeal to the High Court can be made against an order of the ITAT, but only on a substantial question of law.

Key Features:

a) The High Court does not re-examine facts.
b) It interprets legal provisions and settles legal disputes.
c) The question of law must be clearly framed and admitted by the Court.

The decision of the High Court is binding within its territorial jurisdiction.

4. Supreme Court (Final Authority)

Though not mentioned in your list, it is important to note that an appeal can lie to the Supreme Court of India against a High Court decision, usually through Special Leave Petition (SLP) under Article 136 of the Constitution. The Supreme Court's decision is final and binding across India.

Summary of Hierarchy

Assessing Officer → CIT(A) → ITAT → High Court → Supreme Court

This multi-layered appellate system ensures justice, legal consistency, and protection of taxpayer rights while maintaining administrative discipline in the tax system.

14.4 RECTIFICATIONAND REVISION

Two important provisions in this regard are Rectification of Mistakes under Section 154 and Revision by the Commissioner of Income Tax under Sections 263 and 264. While rectification is limited to correction of apparent errors, revision is a supervisory power exercised by the Commissioner to safeguard the interests of revenue or grant relief to the assessee.

14.4.1 Rectification of Mistakes (Section 154)

Rectification refers to the correction of a mistake that is apparent on the face of the record. It is not a mechanism for reviewing or reconsidering the entire assessment order but is confined to correcting obvious and patent errors.A mistake apparent on record is one which:

- Is obvious and self-evident;
- Does not require long-drawn reasoning or interpretation;
- Is clerical, arithmetical, or factual in nature.

Examples include:

- Mathematical errors in computation of income or tax;
- Incorrect application of a tax rate;
- Omission to allow a statutory deduction clearly available on record;
- Typographical or clerical errors.

However, issues involving debatable points of law cannot be rectified under Section 154, as they require detailed examination and interpretation.

Authorities Empowered to Rectify : The following authorities may exercise rectification powers:

- Assessing Officer;
- Commissioner of Income Tax (Appeals);
- Income Tax Appellate Tribunal.

Rectification may be carried out either:

- Suo motu (on the authority's own motion), or
- On an application made by the assessee.

Time Limit for Rectification :Rectification must be made within four years from the end of the financial year in which the order sought to be amended was passed. If the rectification results in enhancement of tax liability or reduction of refund, the assessee must be given a reasonable opportunity of being heard in accordance with the principles of natural justice. Rectification thus serves as a limited but effective tool to correct manifest errors without reopening the entire assessment.

14.4.2 Revision by the Commissioner of Income Tax

Revision is a supervisory power granted to the Commissioner of Income Tax to examine the correctness and legality of orders passed by subordinate authorities. Unlike rectification, revision permits a broader review of the order.

There are two types of revision under the Act:

A. Revision in the interest of revenue (Section 263)
B. Revision in favour of the assessee (Section 264)

A. Revision in the Interest of Revenue – Section 263

Under Section 263, the Commissioner may call for and examine the record of any proceeding under the Act. If he considers that the order passed by the Assessing Officer is:

- Erroneous; and
- Prejudicial to the interests of the revenue, he may revise such order.

Both conditions must be satisfied simultaneously. An order cannot be revised merely because it is erroneous unless it also causes prejudice to the revenue.

Situations Where Section 263 May Apply

- Failure of the Assessing Officer to make proper inquiry;
- Incorrect allowance of deduction or exemption;

- Misapplication of legal provisions;
- Passing an order without adequate verification.

Before passing a revisional order, the Commissioner must provide the assessee an opportunity of being heard.

Powers of the Commissioner under Section 263

The Commissioner may:

- Enhance the assessment;
- Modify the assessment;
- Cancel the assessment and direct fresh assessment.

Time Limit : The revisional order must be passed within two years from the end of the financial year in which the original order was passed.

(B) Revision in Favour of the Assessee – Section 264

Section 264 empowers the Commissioner to revise any order passed by a subordinate authority in favour of the assessee. This provision acts as a relief mechanism where an assessee has not filed an appeal but seeks relief from hardship.

Features of Section 264:

- Can be initiated on application by the assessee or suo motu by the Commissioner;
- Cannot be exercised where an appeal has already been filed and decided;
- Intended to provide relief and mitigate hardship.

The application for revision must generally be made within one year from the date on which the order was communicated to the assessee.

14.4.3 Distinction Between Rectification and Revision

Rectification and revision differ in scope and purpose. Rectification is limited to correction of obvious errors apparent on record, whereas revision involves supervisory re-examination of the order.

Rectification does not permit reconsideration of debatable issues, while revision under Section 263 enables the Commissioner to correct substantial errors affecting revenue. Similarly, Section 264 enables granting relief to the assessee even where no appeal has been filed.

14.5 PENALTIES UNDER THE INCOME TAX ACT

Penalties are imposed to ensure compliance with tax laws. They may be levied for failure to file returns, under-reporting or misreporting of income, failure to maintain books of accounts, and non-compliance with notices. The major categories of penalties:

(A) Penalty for Failure to File Return of Income :
Timely filing of return of income is a statutory obligation under Section 139(1). Failure to file return within the prescribed due date attracts consequences:

(i) Late Filing Fee – Section 234F

If a return is filed after the due date but before the end of the assessment year, a fee is payable:

•₹5,000 in general cases;
•₹1,000 where total income does not exceed ₹5,00,000.

If the return is not filed at all and income exceeds the basic exemption limit, prosecution provisions may also apply (discussed later).

(ii) Interest Liability

In addition to late fee, interest under Sections 234A, 234B, and 234C may also be levied for delay in filing and payment of tax.

(B) Penalty for Under-Reporting of Income:
Section 270A provides for penalty where income is under-reported. Under-reporting occurs when the income assessed is greater than the income determined in the return processed.

Situations of Under-Reporting:
•Failure to report certain income;
•Disallowance of expenses;
•Addition made during assessment;
•Incorrect claim reducing taxable income.

Rate of Penalty:50% of tax payable on under-reported income.

(C) Penalty for Misreporting of Income
Misreporting is a more serious offence and involves deliberate concealment or falsification.

Instances of Misreporting:
•Misrepresentation or suppression of facts;
•Failure to record investments;
•Claim of false expenses;
•Recording false entries in books;
•Failure to report international transactions.

Rate of Penalty:200% of tax payable on misreported income.

14.6 PROSECUTION UNDER THE INCOME TAX ACT

Prosecution involves criminal proceedings for serious tax offences such as wilful attempt to evade tax, failure to deposit TDS, and falsification of accounts. Conviction may lead to rigorous imprisonment and fine. It is initiated in cases involving deliberate evasion or fraudulent conduct:

(A) Failure to File Return – Section 276CC
Where a person willfully fails to furnish return of income:
•Imprisonment ranging from 3 months to 7 years;
•Fine may also be imposed.
The severity depends on the amount of tax sought to be evaded.

(B) Willful Attempt to Evade Tax – Section 276C

If a person willfully attempts to evade tax, penalty, or interest:
•Rigorous imprisonment;
•Fine;
•Both.
This applies in cases of intentional concealment or fraudulent conduct.

(C) False Statement or Verification – Section 277
Making false statements in verification or delivering false accounts may lead to prosecution with imprisonment and fine.

14.7 RECENT DEVELOPMENTS IN INCOME TAX

In recent years, the Indian Income Tax system has undergone significant structural and technological reforms aimed at improving transparency, efficiency, and taxpayer convenience. Key developments include the introduction of Faceless Assessment, E-filing and Pre-filled Returns, the New Tax Regime, and amendments through the annual Finance Act. These reforms represent a shift toward a technology-driven and taxpayer-centric administration.

14.7.1 Faceless Assessment: Faceless Assessment was introduced to eliminate direct physical interaction between taxpayers and tax अधिकारियों, thereby reducing discretion, increasing transparency, and minimizing corruption.

Objectives:

•To promote transparency and accountability;

•To eliminate personal interface between taxpayer and tax authority;

•To introduce team-based assessment with functional specialization;

•To ensure greater efficiency through technology.

Key Features:

•Electronic communication through the income tax portal;

•Random allocation of cases to assessment units;

•Separate units for assessment, verification, technical assistance, and review;

•No requirement for physical appearance except through video conferencing (if necessary).

Under this system, all notices, responses, and orders are exchanged digitally. The process enhances objectivity and reduces bias in tax proceedings.

14.7.2 E-Filing and Pre-Filled Returns: The Income Tax Department has strengthened digital compliance by introducing a fully integrated e-filing portal.

E-Filing System:

•Online filing of Income Tax Returns (ITR);

•Electronic verification through Aadhaar OTP, net banking, or digital signature;

•Online tracking of refund status;

•Online response to notices and compliance requirements.

Pre-Filled Returns:

The system now provides pre-filled information based on:

•Form 16 (salary details);

•Form 26AS (TDS details);

•Annual Information Statement (AIS);

•Bank interest and dividend income;

•Securities transactions.

Pre-filled returns reduce errors, improve accuracy, and encourage voluntary compliance. Taxpayers must, however, verify and confirm correctness before submission.

14.7.3 New Tax Regime vs. Old Tax Regime : The New Tax Regime was introduced under Section 115BAC to provide concessional tax rates with fewer deductions and exemptions.

Old Tax Regime:

•Higher tax rates;

•Allows various deductions and exemptions such as:

•Section 80C (LIC, PPF, etc.);

•Section 80D (Medical insurance);

•HRA exemption;

•Standard deduction.

New Tax Regime:

•Lower slab rates;

•Most deductions and exemptions are not allowed;

•Simplified structure;

•Standard deduction and certain limited benefits allowed in updated versions.

Taxpayers may choose between regimes based on which is more beneficial. The new regime aims at simplification, whereas the old regime rewards savings and investments.

14.7.4 Latest Amendments of the Finance Act:

Each year, the Finance Act introduces amendments to the Income Tax Act to align tax policy with economic objectives.

Recent trends in Finance Act amendments include:

•Rationalization of tax slabs and surcharge rates;

•Introduction of digital reporting requirements;

•Changes in TDS/TCS provisions;

•Measures to curb tax evasion;

•Incentives for startups and MSMEs;

•Increased focus on data analytics and information sharing.

The amendments reflect the government's objectives of widening the tax base, improving compliance, and promoting economic growth.

These recent developments demonstrate a transformation from a traditional compliance-based system to a modern, technology-driven tax administration. Faceless assessment enhances transparency, e-filing simplifies compliance, the new tax regime offers flexibility, and Finance Act amendments ensure that the tax system remains responsive to changing economic realities. Together, these reforms strengthen efficiency, fairness, and taxpayer confidence in the Indian Income Tax system.

14.8 CHECK YOUR PROGRESS

1. What is meant by appeal under the Income Tax Act?
2. Who is the first appellate authority and what are its powers?
3. What is rectification of mistakes under Section 154?
4. What is revision under Section 263?
5. What is the penalty for failure to file return of income?
6. What is under-reporting of income under Section 270A?
7. What is misreporting of income and its penalty rate?
8. What is prosecution under the Income Tax Act?
9. What is faceless assessment?
10. Fill in the blanks
    a) The first appellate authority under the Income Tax Act is ____.
    b) Rectification of mistakes is provided under Section ____ of the Income Tax Act.
    c) The penalty for under-reporting of income under Section 270A is ____% of the tax payable.
    d) Willful attempt to evade tax is punishable under Section ____.

e) The system introduced to eliminate physical interaction between taxpayer and tax authorities is called ____ assessment.

14.9 LET US SUM UP

- The Income Tax Act provides an appellate hierarchy—CIT(A), ITAT, High Court, and Supreme Court—to resolve disputes. It also includes rectification of mistakes and revision powers of the Commissioner to correct erroneous orders.
- Errors apparent on record can be corrected under rectification provisions, while the Commissioner can revise orders either in the interest of revenue or in favour of the assessee.
- Monetary penalties are imposed for non-compliance such as failure to file return, under-reporting, and misreporting of income, ensuring discipline in tax compliance.
- Serious and willful violations, such as tax evasion or failure to file returns, may lead to criminal proceedings including imprisonment and fines.
- Recent Developments: Introduction of faceless assessment, e-filing and pre-filled returns, option between new and old tax regimes, and amendments through the Finance Act have modernized tax administration and improved transparency.

14.10 Answer Your Progress

1. Appeal is a statutory remedy available to an assessee who is aggrieved by an order passed by a tax authority. It allows the taxpayer to challenge the decision before a higher authority for correction or review.
2. The Commissioner of Income Tax (Appeals) [CIT(A)] is the first appellate authority. It has the power to confirm, reduce, enhance, or annul the assessment after giving an opportunity of being heard.
3. Rectification under Section 154 refers to correction of mistakes apparent on the face of the record, such as clerical or arithmetical errors. It cannot be used to review debatable issues.
4. Revision under Section 263 allows the Commissioner to revise an order passed by the Assessing Officer if it is erroneous and prejudicial to the interests of the revenue.
5. Failure to file return within the due date attracts a late filing fee under Section 234F (₹5,000 or ₹1,000 in certain cases) and may also attract interest and prosecution in serious cases.
6. Under-reporting of income occurs when assessed income is greater than the income reported in the return. The penalty is 50% of the tax payable on such under-reported income.
7. Misreporting of income involves deliberate concealment or falsification of income. The penalty for misreporting is 200% of the tax payable on the misreported income.
8. Prosecution involves criminal proceedings for serious and willful violations such as tax evasion or failure to file return, which may result in imprisonment and fine.

9. Faceless assessment is a digital system where assessment proceedings are conducted electronically without physical interaction between the taxpayer and tax authorities, ensuring transparency and efficiency.
10. Fill in the blanks:

a) Commissioner of Income Tax (Appeals) [CIT(A)]
b) 154
c) 50
d) 276C
e) Faceless

14.11 FURTHER READING

1. Singhania, V. K., & Singhania, K. (2024). Direct Taxes Law and Practice (Title may vary by edition). New Delhi, India: Taxmann Publications.
2. Ahuja, G., & Gupta, R. (2024). Systematic Approach to Income Tax (Latest Edition).
3. Lal, B. B., & Vashisht, N. (2024). Direct Taxes – Law & Practice (Latest Edition).
4. Mehrotra, H. C., & Goyal, S. (2024). Income Tax Law and Accounts (Latest Edition).
5. Income Tax Act, 1961 with latest Finance Act amendments (2025).

14.12 MODEL QUESTIONS

1. Explain the appellate hierarchy under the Income Tax Act.
2. What are the time limits for filing an appeal before CIT(A) and ITAT?
3. Distinguish between rectification under Section 154 and revision under Section 263.
4. Under what conditions can the Commissioner invoke powers under Section 263?
5. What are the powers of the Income Tax Appellate Tribunal (ITAT)?
6. Discuss the difference between under-reporting and misreporting of income.
7. What are the consequences of willful failure to file return of income?
8. Explain the concept of compounding of offences under the Income Tax Act.
9. Compare the features of the Old Tax Regime and the New Tax Regime.
10. Discuss the objectives and advantages of faceless assessment and faceless appeal schemes.