



**T.Y.B.Com.**  
**Paper - V**  
**DIRECT AND INDIRECT TAX**

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**I**  
**TY B COM**  
**Paper - V**  
**DIRECT AND INDIRECT TAX**  
**SYLLABUS**

**Basic Term**

**s (S: 2, 3, and 4)**

Assessee

Assessment

Assessment Year

Annual value

Business

Capital Assets

Income

Person

Previous Year

Transfer

**1.2 Scope of Total Income (S: 5)**

Residential Status (S: 6)

**1.3 Heads of Income (S: 14; 14A)**

(i) Salary (S: 15 to 17)

(ii) Income from House Properties  
(S: 22 to 27)

(iii) Profit and Gain from Business (S: 28, 30, 31, 32, 35, 35D, 36,  
37, 40, 40A and 43B)

(iv) Capital Gain (S: 45, 48, 49, 50, 54)

v) Income from Other Sources (S: 56 to S: 59) Exclusions from  
Total Income

(S: 10) Exclusion related to specified heads to be covered with  
relevant head. eg. Salary, Business Income, Capital Gain,  
Income from Other Sources

**1.4 Deduction from Total Income**

S 80C, 80CCC, 80D, 80DD, 80E, 80 U

**1.5 Computation of Total Income for Individual**

**Notes:**

1. The Syllabus is restricted to study of particular sections, specifically mentioned rules and notifications only.
2. All modules / units include Computational problems / Case Study.

## II

3. The Law In force on 1st April immediately preceding the commencement of Academic year will be applicable for ensuing Examinations.

## SYLLABUS

### GST

Sr. No. Modules / Units

#### 1. Introduction

What is GST

Need for GST

Dual GST Model

Definitions

- Section 2(17) Business
- Section 2(13) Consideration
- Section 2(45) Electronic Commerce Operator
- Section 2(52) Goods
- Section 2(56) India
- Section 2(78) Non taxable Supply
- Section 2(84) Person
- Section 2(90) Principal Supply
- Section 2(93) Recipient
- Section 2(98) Reverse charge
- Section 2(102) Services
- Section 2(105) Supplier
- Section 2(107) Taxable Person
- Section 2(108) Taxable Supply

Goods & Services Tax Network (GSTN)

#### 2. Levy and Collection of Tax

- Scope of Supply
- Non taxable Supplies
- Composite and Mixed Supplies
- Composition Levy

### **III**

- Levy and Collection of tax
- Exemption from tax

#### **3. Time, Place and Value of Supply**

- Time of Supply
- Place of Supply
- Value of Supply

#### **4. Input Tax Credit & Payment of Tax**

- Eligibility for taking Input Tax Credit
- Input Tax Credit in Special Circumstances
- Computation of Tax Liability and payment of tax

#### **5. Registration under GST Law**

- Persons not liable registration
- Compulsory registration
- Procedure for registration
- Deemed registration
- Cancellation of registration



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## SECTION-I: DIRECT TAXES

### INCOME TAX

---

# 1

## INTRODUCTION AND BASIC CONCEPTS

### Synopsis

1. Introduction and Objectives
2. Assessment Year
3. Previous Year
4. Person
5. Assessee
6. Assessment
7. Income
8. Gross Total Income
9. Total Income
10. Scheme of charging Income tax
11. Self Examination Questions

---

### 1. INTRODUCTION AND OBJECTIVES :

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Under Entry 82 of the Schedule VII to the Constitution of India, the Central Government is empowered to levy 'Tax on income other than agricultural income in India. Accordingly , the parliament has enacted Income Tax Act, 1961["The Act"] to provide for the scope and machinery for levy and collection of Income Tax in India, supported by Income Tax Rules,1962 and several other subordinate rules and regulations.

Further, the Central Board of Direct Taxes (CBDT) and the Ministry of Finance, Government of India issue from time to time circulars and notifications dealing with various aspects of the levy of Income tax.

Unless otherwise stated, references to the sections will be the reference to the sections of the Income Tax Act, 1961.

Section 4, which is the charging section, states that income tax is a **tax** on **the total income** of a **person** called the assessee of **the previous year** relevant to the **assessment year** at the rates prescribed in the relevant Finance Act

This phrase sets the tone and agenda of any study on income tax law. This comprises of the understanding of the following:

- Concept of assessment year and previous year,
- Meaning of person and assessee,
- How to charge tax on income,
- What is regarded as income under the Income-tax Act,
- What is gross total income,
- What is total income or taxable income and
- Income-tax rates

This lesson deals with all these aspects, which lay down the basic framework for levy of income tax in India and explain the basic concepts and terms used in the income tax law.

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## **2. ASSESSMENT YEAR – SECTION 2(9)**

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Section 2(9) defines an “Assessment year” as **“the period of twelve months starting from the first day of April every year”**

An assessment year begins on 1<sup>st</sup> April every year and ends on 31<sup>st</sup> March of the next year. Hence, the assessment year 2018-19 means the period of one year beginning on 1<sup>st</sup> April, 2018 and ending on 31<sup>st</sup> March, 2019.

Income of an assessee during the previous year is taxed in the relevant assessment year. It is therefore, also called as the “tax year”

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## **3. PREVIOUS YEAR- SECTIONS. 2(34) & 3**

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### **3.1. Definition:**

Section 3 defines “previous year” as **“the financial year immediately preceding the assessment year”**.

Income earned by an assessee in one financial year is taxed in the next financial year. The year in which income is earned is called the “previous year” and the year in which it is taxed is called the “assessment year”.

This will be explained from the following illustrations:

### **Illustrations**

1. Income earned during financial year 2017-18 will be taxed in the financial year 2018-19. Hence, 2018-19 will be the assessment year and the preceding financial year 2017-18 will be the previous year.

2. For the assessment year 2017-18, previous year will be 2016-17 i.e. from 1<sup>st</sup> April, 2016 to 31<sup>st</sup> March 2017.



### 3.2. Common previous year for all source of income:

A person will be liable to pay taxes on his total income earned from different sources during the previous year. In other words, the previous year will be common for all sources of income, even if he maintains records or books of accounts separately for different sources of income.

#### Illustration

During the financial year 2017-18, Ashok gets salaries of Rs 2 lakh from X Limited and Rs 4 lakh from Y Limited. His professional income is Rs 2.50 lakh. Ashok also receives dividend Rs 1 lakh and interest Rs 0.75 lakh. Thus his aggregate income works out to Rs 10.25 lakh.

For all these sources the previous year will be 2017-18 and assessment year 2018-19 and Ashok will be liable to pay tax on aggregate income of Rs. 10.25 lakh from all the sources.

### 3.3. New Business or Profession:

Where a business is newly set up during a financial year or where a new source of income has arisen during that financial year, the previous year will be the period (obviously less than one year) commencing from the date of setting up of the new business or the date of new source of income arising.

#### Illustration

R sets up a business in March, 2018. The period of one month beginning on 1st March 2018 and ending on 31st March, 2018 will be the previous year 2017-18 and taxed in the assessment year 2018-19. It is immaterial that previous year is of a period of less than 12 months.

### 3.4. Exception

As a rule, income of the previous year is taxable in the next assessment year. This rule is however, subject to some exceptions. In some cases an assessee is liable to pay tax on the income in the same previous year in which he earns it. These exceptional cases ensure safeguards to smooth collection of income tax from a class of taxpayers who may not be traceable until the commencement of the normal assessment year. In such cases, previous year and assessment year will be the same. Some of such exceptions are as under:-

- a) Realisation of bad debts written off in the earlier years and allowed as deduction – Sec. 41(1)
- b) Deemed dividend – Sec. 56
- c) Income of non-residents from shipping business—Sec.172;
- d) Income of persons leaving India permanently or for a long period of time and not likely to return back –Sec. 173-174;
- e) Income of bodies formed for short duration for a particular event or purpose – Sec 174A;

- f) Income of a person trying to alienate his assets with a view to avoiding payment of tax – Sec. 175 ,
- g) Income of a discontinued business- Sec.176

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## 4. PERSON –SECTION 2(31)

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### 4.1 Definition:

As per section 2(31) “person” includes:

- a) an individual;
- b) a Hindu undivided family (HUF);
- c) a company;
- d) a firm;
- e) an association of persons(AOP) or a body of individuals,(BOI) whether incorporated or not;
- f) a local authority; and
- g) every artificial juridical person not falling within any of the preceding categories

### 4.2 Inclusive definition:

The definition of “person” is inclusive, not exhaustive. there may be cases, when an entity not falling in the above seven categories may still be treated as “person” inviting the provisions of the Act.

### 4.3 Profit motive not necessary:

As per Explanation to section. 2 (31), an entity need not be formed for profit. Non-profit organisations or charitable trusts are also covered by the definition of “person” although their income is not taxable under the Act on satisfying the certain terms and conditions.

### 4.4 Description of types of persons :

A brief description of these seven categories is as follows:

- a. **Individuals** are all living persons of blood and flesh e.g. Arun , Arvind , Nirmala, Albert, Ibrahim etc.
- b. **Hindu Undivided Families** (HUF) or Hindu joint families are regarded as separate tax entities in view of the specific law of succession prevalent among the Hindus.
- c. As per section 2(31), **Company** includes any Indian, or foreign, public or private Company, or a charitable or non-profit company incorporated u/s 8 of the Companies Act, 2013 (old section 25 of the Companies Act, 1956). However, they can claim exemption from tax, on compliance of the legal conditions given in other provisions of the Act. Further, the CBDT has the power to declare any institution as a company.

- d. **Partnership firms** including limited liability partnerships (LLPs) are regarded as distinct taxable units separate from their partners. Therefore, under the Act, firms are taxed as the firms and individual partners are taxed separately in their personal capacity.
- e. Body of individual (**BOI**) and association of persons (**AOP**) are the group of persons carrying on some activities to earn income such as joint venture.

Normally, AOPs are contractual in nature like a joint venture agreement if such venture not formed as a partnership or a company.

On the other hand, BOI may be due to circumstances such as joint owner of a estate. Clubs, societies, charitable trusts etc. are covered under this head.

- f. Municipal corporations, panchayats, cantonment boards, zila parishads etc. are the examples of Local authorities.
- g. Final category is residual category and covers all such persons which are not covered in any of the above six categories.

### Illustration

Determine the status in the following persons as per the Income Tax Act, 1961:

Person	Status
Rajul	Individual
Smita	Individual
Reliance Infra Limited	Company
Gokul Co-society Ltd	AOP
Indian Red Cross Society	AOP
Legal heirs to receive property of late Shri Nusserwanji	BOI
Tata Power Ltd	Company
Virat Kohli	Individual
Board for Cricket Control in India	AOP
Family of Shri PB Hindu	HUF
Pune Cantonment Board	Local Authority
Pune University	Artificial Juridical Person
Ramu Brothers doing business in partnership	Firm

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## 5. ASSESSEE–SECTION 2(7)

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### 5.1 Definition

As per section 2(7), “assessee” means a person by whom income tax or any other sum of money is payable under the Act and it includes:

- a. every person in respect of whom any proceeding under the Act has been taken for the assessment of his income or assessment of fringe benefits or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person ;
- b. every person who is deemed to be an assessee under any provision of this Act ;
- c. every person who is deemed to be an assessee in default under any provision of this Act.

**5.2** The definition of “assessee” is also inclusive and very wide in scope. It includes any other person not covered in the above categories. The definition covers not only a person but also his representative such as legal heir, trustee, liquidator of a company assessee etc. Moreover, importance is given not only to the amount of tax payable but also to refund due and the proceedings taken.

**5.3** Thus, an assessee may be :-

1. A person by whom income tax or any other sum of money is payable under the Act
2. A person in respect of whom any proceeding under the Act has been taken for the assessment of his :
  - a. income or
  - b. loss or
  - c. the amount of refund due to him
3. A person who is assessable in respect of income or loss of another person or
4. A person who is deemed to be an assessee,
5. An assessee in default under any provision of the Act.

**5.4** A minor child is a separate assessee, but his income is included in the income of the parent having the higher income unless, such income is from an asset assets acquired from the minor’s sources of income or income generated out of activities performed by him like singing in radio jingles, acting in films, tuition income, delivering newspapers, etc.

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## 6. ASSESSMENT - SECTION 2(8)

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The Act does not define “assessment”. Instead, section 2(8) states “**an assessment includes reassessment**”.

In common parlance, assessment is the procedure to determine the taxable income of an assessee and the tax payable by him.

Section 139, requires an assessee to file in prescribed form a self-declaration of his income and tax payable by him called "return of income".

The Income Tax officer may accept the return summarily without making any enquiry into its contents. This is called as the 'summary assessment' under section 143(1).

Alternatively, the officer calls upon the assessee to explain his return of income and after making necessary enquiry, frames a reasoned order determining the total income and the tax payable by the assessee this is called the "regular assessment" under section 143(3).

Completed assessment becomes final except in certain circumstances. These circumstances are:

- a. U/s 147, an assessment can be reopened to assess income which has escaped assessment.
- b. U/s 263, the Commissioner of Income Tax may ask an assessment to be redone if the assessment order is erroneous and prejudicial to the interest of the revenue.
- c. U/s 264, the Commissioner of Income Tax at the application of an assessee or *suo motu*, may ask an assessment to be redone. This is normally done to give relief to the assessee.
- d. U/s 254, the Income Tax Appellate Tribunal (ITAT) in appeal proceedings may pass an order directing the assessment to be redone.

In all the above cases "reassessment" of the income is required to be done. The definition of assessment includes the regular assessment and reopened or reassessment.

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## 7. INCOME- SECTION 2(24)

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### 7.1 Definition :

Sec 2(24) gives an inclusive definition of income. It states that Income" includes—

- (i) profits and gains ;
- (ii) dividend;
- (iia) **voluntary contributions** received by -
  - a trust created wholly or partly for **charitable for religious** purposes, or

- any institution, an association or a fund or trust or institution for **scientific research** u/s 10(21) / (23);
- any university or other **educational institution** referred to in section 10 (23) (iiia) or (vi) (**sports body**) ;
- any **hospital** or other institution u/s 10(23C) (iiia) / (via),
- By an **electoral trust**.

For this purpose, "trust" includes any other legal obligation;

### **Receipt by employees**

(iii) The value of **any perquisite or profit in lieu of salary** taxable under section 17(2) / (3);

(iiia) **any special allowance or benefit**, (other than perquisite), 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 ;

(iiib) any allowance granted to the assessee either 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( **City Compensatory Allowance**) ;

(iv) 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;

(iva) the value of any **benefit or perquisite**, whether convertible into money or not, obtained by any representative assessee mentioned in section 160(1) (iii) or (iv) of or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee (the "beneficiary") and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary;

(v) Any sum chargeable to income-tax (Balancing **charge**) under section 28 (ii) / (iii) or section 41 or section 59);

### **Benefits to exporters**

- (va) Duty drawback under section 28 (iiia);
- (vb) Cash Assistance under section 28 (iiib);
- (vc) DEPB under section 28 (iiic);
- (vd) the value of any benefit or perquisite taxable u/s 28 (iv);
- (ve) any sum chargeable to income-tax u/s 28 (v);
- (vi) any **capital gains** chargeable under section 45;

(vii) the profits and gains of any **business of insurance** carried on by a mutual insurance company or by a co-operative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule ;

(viiia) the profits and gains of any **business of banking** (including providing credit facilities) carried on by a co-operative society with its members;

(viii) Omitted

(ix) 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.

For this purpose,—

(i) "lottery" includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;

(ii) "card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game ;

(x) any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948 , or any other fund for the welfare of such employees ;

(xi) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

(xii) any sum referred to in section 28 (va) ;

#### **Gifts without consideration**

(xiii) any sum referred to in section 56 (2)(v);

(xiv) any sum referred to in section 56 (2)(vi);

(xv) any sum of money or value of property referred to in section 56 (2) (viiia) ;

(xvi) any consideration received for issue of shares as exceeds the fair market value of the shares referred to section 56(2) (viib)

(xvii) any sum of money referred to in section 56 (2)(ix);

(xviiia) any sum of money or value of property referred to in section 56 (2)(x)

(xviii) assistance by way 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 other than.

(a) the subsidy or grant or reimbursement which is reduced from the actual cost of the asset u/s 43 (1) Explanation 10; or

(b) the subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or a State Government.

**7.2.** Section 2(24) gives an inclusive definition of “income”, which covers income in its natural and general sense and also several items not otherwise considered as income.

Income means not only the revenue receipts arising or accruing regularly but also capital receipts like gifts and even donations and gifts. On the other hand, certain revenue receipts like agricultural income are left out from the scope of the term income.

Some of the principles that have emerged out as a result of customs, practices and judicial pronouncements to ascertain as to what does or does not constitute income are as follows.

1. Ordinarily Income is a regular periodical receipt, received or derived from a certain source.
2. The source of income must be external. No one can earn income by or from himself.
3. On this principle, income accruing to clubs, societies etc. from their own members are not taken as taxable income on the ground of mutuality.
4. Normally, only revenue receipts are regarded as income unless specifically exempted.
5. On the other hand, capital receipts are not treated as income unless the law specifically provides e.g. capital gains, gifts, maturity proceeds of keyman insurance policy, sales tax subsidy, voluntary contribution by a donor to a trust, which are included in income in spite of being capital receipts.

Income is like the fruit of a tree, where tree is the source, or the capital asset.

6. Income may be in cash or kind.
7. Income need not be legal. It may even be derived from illegal sources like, smuggling, theft, bribery, corruption etc.
8. It is the receipt, which is income not its application or use.
9. Any receipt diverted at the origin or the source by overriding title will not be regarded as income.



10. Any dispute in the title of the income does not take away its nature as income.
11. A gift is a capital receipt given for personal considerations. However, there is no longer valid proposition as the law specifically provides for taxation of gifts, e.g.:
  - gift by an employer to an employee is deemed to be taxable salary u/s 17.
  - Gift by a client or customer is deemed as the income under the head profits and gains from business or profession u/s 28. Hence, a gift given by a client to his lawyer or chartered accountant or a patient to his doctor, or a disciple or pupil to his guru, will be taxable as the income of the recipient (donee) from business or profession u/s 28.
  - Personal gifts in excess of Rs. 50,000, from all sources are taxable as income from other sources u/s 56 subject to certain exceptions. Further, inadequate consideration on transfer of immovable or movable assets is also considered as taxable gift u/s 56. This aspect is dealt with in great detail in the lesson relating to income from other sources
12. Income may be recognised either on receipt basis or on accrual basis depending upon the facts and circumstances of and the method of accounting applied in each case.
13. Income must be certain. Contingent income is not regarded as income unless and until such contingency occurs and the income arises to the assessee.
14. Income is the sum total of all receipts from all the sources and considered accordingly.
15. Pin money received by a woman for personal expenses or even the savings made by her from such receipts is not considered as income. However, the husband will not get any credit from his income for these payments.
16. Income may be received in lump sum or in instalments. Thus, arrears of salary received by a person in lump sum are regarded as his income.
17. Awards received by a professional sportsperson would be income, unless the award is in nature of a gift for personal consideration.
18. Income of wife is to be taxable in the hands of the husband if the assets out of which the income is arising have not been acquired out of the sources of the wife or from an asset gifted by the husband except as consideration for living apart.
19. Income of minor children is to be taxable in the hands of the parents having higher income [mother or father] except

when the income is arising from the efforts of the minor child say modeling charges.

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## **8. GROSS TOTAL INCOME- SECTION 14**

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Section 14 of the Act defines the gross total income as the aggregate of the incomes computed under the five heads after adjusting for set-off and carry forward of losses. The five heads of income are as follows namely:

1. Income from salaries,
2. Income from house property,
3. Profits and gains from business & profession,
4. Capital gains, and
5. Income from other sources

The gross total income is the aggregate of income computed in accordance with the provisions of the Act under the five heads, before making any deduction under sections 80C to 80U. Any income exempted from tax u/s 10 or other provisions E.G., conveyance allowance, capital gains on sale of personal effects, dividend income, etc. ; is not considered or excluded from the income computed under the respective heads.

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## **9. TOTAL INCOME:**

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The total income of an assessee is computed by deducting from the gross total income all permissible deductions available under the Chapter VI A of the Income Tax Act, 1961. This is also referred to as the “Net Income” or “Taxable Income”.

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## **10. SCHEME OF CHARGING INCOME TAX**

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Income tax is a tax on the total income of an assessee for a particular assessment year. This implies that;

- Income-tax is an annual tax on income.
- Income of previous year is chargeable to tax in the next following assessment year at the tax rates applicable for the assessment. year This rule is, however, subject to some exceptions discussed above.
- Tax rates are fixed by the annual Finance Act and not by the Income-tax Act. For instance, the Finance Act, 2018 fixes tax rates for the financial year 2017-18 relevant to assessment year 2018-19. Tax rates are given in the lesson dealing with computation of income.
- Tax is charged on every person if the total income exceeds the minimum income chargeable to tax.

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## 11. SELF ASSESSMENT QUESTIONS

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1. Income of a previous year is chargeable tax in the immediately following assessment year. Is there any exception to this rule? Discuss
2. Define the term “person”
3. How would you calculate income tax for the assessment year 2018-19 in the case of different assesses?
4. Explain how education cess will be computed for the assessment year 2018-19? [Ans: 2%+1% ]
5. What will be the previous year for X, who starts his business on April 6, 2014[ Ans: A.Y. 2015-16]
6. Will the answer to Q 5 be different, if X starts his business on 28th March, 2014? [ Ans: A.Y. 2014-15]
7. Explain that a financial year is a previous year and also an assessment year. Every financial year can also be an assessment year,
8. Previous year is a financial year immediately preceding the Assessment year Comment
9. What will be the status of University of Mumbai?  
[Ans: Artificial juridical person]
10. Indicate whether the following persons will be taxed as individuals:
  - a) X a partner of a firm
  - b) Y, a managing director of A Ltd;”
  - c) Z is the member of Z HUF
  - d) Municipal Commissioner of Mumbai in respect of the Income of the Municipal Corporation
  - e) Municipal Commissioner of Mumbai in respect of his salary from the Municipal Corporation
  - f) A minor acting in TV commercials

[Ans: All except (d) will be taxed, Firm X, A Ltd, Z HUF, Mun Corpn. Separate tax entities]



## **BASIS OF CHARGE AND INCIDENCE OF TAX**

### **Synopsis**

1. Introduction and Objectives
2. Basic Charge of Income Tax
3. Residential Status
4. Residential status and incidence of tax
5. Income deemed to be received in India
6. Income deemed to accrue or arise in India
7. Receipt vs. Remittance
8. Actual receipt Vs. Deemed Receipt Total Income
9. Receipt vs. Accrual
10. Basis of Charge of Dividend Income
11. Heads of Income
12. Self-Examination Questions

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### **1. INTRODUCTION AND OBJECTIVES**

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This lesson deals with the law contained in sections 4 to 9, with regard to the basis of charging income tax, scope of total income, on which tax is to be levied, residential status and its effect on tax liability of the assessee, periodicity of the tax and other incidental matters.

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### **2. BASIS OF CHARGE OF INCOME TAX ( Ss. 4-9 )**

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Provisions of section 4 to 9 with regard to the scheme and basis of charge of income tax in India are given as under.

#### **I. Charge of income tax- section 4**

As per section 4(1), income tax shall be charged for any assessment year at any rate or rates prescribed in the Finance Act in respect of the total income of the previous year of every person. Accordingly, as per the section

- Tax is payable( including by way deduction at the source or paid in advance);
- on total income;
- of a person called assessee;

- during the previous year or a period other than the previous year ( as per proviso to the section);
- Relevant to assessment year,
- At the rate or rates prescribed in the Finance Act,

## **II. Scope of total income- Section 5**

As per section 5, total income of an assessee is chargeable to tax depending upon-

- a) the residential status of a person; and
- b) place and time of accrual of such income.

## **III. Residential statues and place – Section 6**

Section 6 provides the rules for determining residential status of different types of persons

## **IV. Income accrued or received in India –Ss. 7-8 & 9**

- Section 7 specifies the incomes, which are not received in India but are deemed to be received in India.
- Section 8 deals with the year of taxability of dividend income.
- Section 9 specifies the incomes though not accrued or arisen in India but are deemed to accrue or arise in India.

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## **3. RESIDENTIAL STATUS –SECTION 6**

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**3.1** As per section 5, total income of an assessee is chargeable to tax depending upon the residential status of a person, place and time of accrual of such income. Section 6 prescribes the rules for determining residential status of different categories of persons. These provisions are discussed in detail below.

### **3.2 Classification of persons:**

Provisions for determination of the residential status are different for different categories of the assessee viz:-

- a) individuals;
- b) Hindu Undivided Families (HUF)
- c) Firms, BOI or Associations of Persons(AOP);
- d) Companies; and
- e) Every other person

### **3.3 Residential status of individual**

#### **3.3.1 Basic conditions: -Section 6(1):**

As per section 6(1), an individual is said to be a resident in India in any previous year, if he satisfies at least one of the following TWO basic conditions viz. : —

- a) He is in India in that previous year for a period or periods amounting in all to 182 days or more; or

- b) He has been in India for a period or periods amounting in all to
- 365 days or more during the 4 years immediately preceding that previous year; and
  - 60 days or more during that previous year.

**Exception:**

The period of stay of 60 or more in India as per condition (b) will be extended to 182 days or more in following two circumstances:

- i. An Indian citizen leaves India during the previous year
  - for the purpose of taking up employment outside India; or
  - as a member of the crew of an Indian ship; or
- ii. An Indian citizen or a person of Indian origin (PIO) comes on visit to India during the previous year.

A person is said to be of Indian origin (PIO) if either he or any of his parents or grandparents was born in undivided India.

In both the cases, an individual has to be present in India for 182 days or more to become resident in India, instead of 60 days. This may result in two possibilities:

- a) An individual may not satisfy either of the two conditions; or
- b) An individual may satisfy any or both of the two basic conditions, then the individual will be -
  - In case (a), a non-resident; and
  - in case (b), a resident of India
 for that particular previous year.

### 3.3.2 Resident and Ordinarily Resident [R & O R ]-Sec-6(6)

If a person is a resident of India in a particular previous year as per section 6(1), next step would be to determine whether he will be a resident and ordinarily resident of India in that previous year as per Section 6(6).

Section 6(6) provides that a person will be “resident and ordinarily resident” in India in any assessment year if he satisfies BOTH of the following two conditions that he has been-

- 1) resident in India in two out of the ten previous years immediately preceding that previous year as per section 6(1); and
- 2) in India for a period of, or periods amounting in all to 730 days or more during the seven previous years preceding that previous year.

### 3.3.3 Resident and Not Ordinarily Resident [R &N O R ]

A resident individual must satisfy both of the above conditions. It is not enough that an Individual satisfies only one of the additional conditions. In other words, an individual will become becomes resident but not ordinarily resident in India, If he -

- (a) is non-resident in nine out of the ten previous years immediately preceding that previous year or
- (b) has during the seven previous years preceding that year been in India for a period , or periods amounting in all to, 729 days or less.

Thus , an individual will be R &N. O. R , if he satisfies at least one of the basic conditions but -

- does not satisfy any of the additional conditions, or
- satisfies any one of the two additional conditions.

### 3.3.4 Non- Resident

An individual is a non-resident in India, if he satisfies none of the basic conditions. This will be so even where a person satisfies the additional conditions but does not satisfy the basic conditions. In such a case, additional conditions are not relevant.

### 3.3.5 SUMMARY

To sum up, an individual can either be:

- (a) resident and ordinarily resident in India;
- (b) resident but not ordinarily resident in India; or
- (c) non-resident

Following table gives the summary of the provisions

Status	Basic Conditions Section 6(1)	Additional Conditions – Section6(6)
Resident and ordinarily Resident	Must satisfy either of the two conditions	Must satisfy both the conditions
Resident but not ordinarily Resident	Must satisfy either of the two conditions	Must not satisfy any one or both the conditions
Non Resident	Does not satisfy any conditions	Not Necessary that the two conditions are satisfied or not.

### 3.3.6 Some Important points:

- a) In computing the day on which a person is in India
  - i. Stay may be at one place or more than one place. Stay at difference places in India will be aggregated.
  - ii. Stay in India may be continuous or in intervals. Stay in intervals will be aggregated.

Both the day of arrival in India and departure from India shall be considered even if on such days the person is in India only for a part of a day. However, the courts have held that *a total of 24 hours of stay spread over a number of days is to be counted as being equivalent to the stay of one day. Students are advised to consider the day of departure and arrival both as two days, if the hours of arrival and departure are not given.*

- b) *A person, who is in India for 182 days or more, will always be a resident of India.*
- c) *Conversely, a person, who is in India for 59 days or less, will always be Non-Resident of India.*
- d) An Indian citizen must leave India for employment or as crew to avail extended limit of 182 days instead of 60 days.
- e) An Indian citizen leaving India Resident and ordinarily in India will not get the extended time limit of 182 days.
- f) The condition is relaxed only for Indian citizens and not for persons, who are not Indian citizens.
- g) Indian citizens or persons of Indian origin (PIO) must come to India on visit for any purpose; pilgrimage, medical treatment or tourism; but not business or job to avail extended limit of 182 days Indian citizenship is not the requirement for this purpose.
- h) While computing the period of stay, note that 2008, 2012 and 2016 were leap years with one extra day.

### **3.3.7 Illustrations :**

1. Ankit leaves India for the first time on May 20, 2015. During the financial year 2017-18, he came to India on June 10 for a period of 55 days.

In this case, Ankit is in India only for 55 days during the previous year 2017-18. He will be a non-resident in India for the assessment year 2018-19 as he does not satisfy any of the basic conditions laid down in section 6(1).

2. Aman, an U.S. citizen arrives in India for the first time in Pune on April 16, 2015. Thereafter, on April 29, 2017, he moves to Mumbai. He leaves Mumbai for his native country on October 8, 2017. Determine his residential status for the assessment year 2018-19

Aman is in India for \*191 days during the previous year 2017-18. As he satisfies the first condition u/s 6(1) of staying in India for 182 days or more, he is a resident in India.

\*(Apr. 30+May 31+ Jun. 30+ Jul.31+ Aug. 31+ Sept 30 +Oct.8)

Aman satisfies the first additional condition u/s 6(6) that he must be a resident in India in at least two year out of the ten preceding years as he was a resident of India during the P.Y.



2015-16 and 2016-17. In 2015-16 he was in India for 351 days from 16 April 2015 to 31 March 2016 (leap year) and for full year or 365 days in 2016-17. (Both years 182 days or more)

But, he does not satisfy the second condition u/s 6(6) as he was in India for a period of 716 days only, (351 days in 2015-16 and 365 days in 2016-17), which is less than 730 days stay required in the seven preceding years.

Aman is a resident but not ordinarily resident in India for the assessment year 2018-19 because he satisfies one of the basic conditions and only one of the two additional conditions,

3. Ravi, an Indian citizen, leaves India on June 30, 2017 to join a job in Canada.

During the P.Y. 2017-18, Ravi was in India for 91 days (April: 30 days; May - 31 days; June: 30 days), which is less than 182 days. Further, he is covered by the exception u/s 6(1) as he is an Indian citizen, leaving India to take up a job.

Hence, Ravi will be a Non -resident for the A.Y. 2018-19 although he was in India for more than 365 days during the four years preceding the previous year

4. Assuming that Ravi leaves India for world tour, he will not be covered by the exception u/s 6(1).

Accordingly he will be a resident of India as he satisfies the second basic condition u/s 6(1) of 365 days' stay in the preceding four years and 60 days stay during 2017-18.

Further, Ravi satisfies both the additional conditions of being resident in India for two years in preceding 10 years and stay of 730 days in seven preceding years. Hence, he will be Resident and Ordinarily Resident of India.

5. Ravi wants to postpone his departure for Canada, then he should depart latest by September 28, 2017 so that his stay in India during the previous year 2017-18 is of 181 days (less than 182 days).

6. Assuming that Ravi is a Nepali citizen settled in India, he will not get the benefit of 182 days u/s 6(1) as he is not an Indian citizen. He satisfies the basic condition (b) and both the additional conditions of 730 days in 7 preceding years and 2 years resident in preceding 10 years, he will be a resident and ordinary resident in India.

7. Bret Lee an Australian citizen comes to India to coach Indian cricket team for a period of 95 days each year from the P.Y. 2013-14 onwards.

In this case, Bret Lee was in India for 380 days during the four years preceding the P.Y. previous year 2017-18 and he

was in India for 95 days in P.Y. 2017-18. Bret Lee is a resident of India as he satisfies the second basic condition u/s 6(1). He is not covered by the exception of 182 days instead of 60 days in India because he is not a person of Indian origin nor he comes in India on visit.

However, Bret Lee will be Resident but not Ordinarily Resident of India [RNOR] because he was never in India and, he does not fulfill the additional two conditions.

8. The position will not be different if Bret Lee is a resident of Bangladesh as he has not come on visit but as a professional coach, although he is Person of Indian origin (PIO), Bangladesh being a part of undivided India.

9. However, if Bret Lee is a Bangladeshi citizen and visits India as a tourist, he will get the extended limit of 182 days and will be a Non- resident.

### **3.4. Residential status of HUF**

#### **3.4.1 Resident**

As per section 6(2), a Hindu Undivided Family (HUF) will be:

- Resident in India if control and management of its affairs is wholly or partly situated in India.
- Non- resident in India only if control and management of its affairs is situated wholly outside India.

#### **3.4.2 Resident and Ordinarily resident (ROR)**

As per section 6(6), a HUF can will be Resident and Ordinarily Resident if its Karta or manager satisfies both of the following two conditions viz. The Karta or the manager :-

- (a) has been a non-resident in India in 9 out of the 10 previous years preceding that year, and
- (b) has during the 7 previous years preceding that year been in India for a period of, or periods amounting in all to 729 days or less

It may be noted that additional conditions are same as those applicable to the individual but applicable on the Karta or the manager of a HUF.

#### **3.4.3 Resident and Not Ordinarily resident (ROR)**

If the Karta does not satisfy both of the two additional conditions, the HUF will be treated as a resident but not ordinarily resident (RNOR) in India

#### **3.4.4 Non-Resident**

A HUF will be non- resident in India only if control and management of its affairs is situated wholly outside India.

The place of control and management of HUF is relevant to determine its status u/s 6(1) whether it is Resident or Non-Resident. However, the two additional conditions U/s 6 (6) are applicable with reference to its Karta or Manager to determine to R & OR status

### Summary

Thus, like an Individual a HUF may be either:-

- (a) Resident and ordinarily in India if is controlled or management wholly or partly in India or
- (b) Non-resident in India if its control or management is wholly outside India.
- (c) Resident and ordinarily in India if two additional conditions as per section 6(6) are satisfied by the Karta / Manager.

### 3.5. Residential Status of Other Non-Company Persons (Section 6(2) / S 6(4))

#### 3.5.1 Resident –S 6(2)

Under Section 6(2) Residential status of all non-company persons viz a firm an Association of Persons (AOP) or a Body of Individuals (BOI) and every other person will also depend upon the place of control and management like HUFs.

Any such person will be:

- Resident in India if control and management of its affairs is wholly or partly situated in India, ;
- Non-resident in India if control and management of its affairs is situated wholly outside India.

#### 3.5.2 Non Resident

An AOP, BOI or a firm will be non-resident in India if control and management of its affairs is situated **wholly outside** India.

These persons can only be either resident or not resident but not ordinarily resident.

#### Illustration

1. An entity has its operations in India but India, but it takes instructions from Dubai either wholly or partly, it will be Resident of India in all the cases a HUF, AOP, d) BOI or other artificial juridical person.
2. If the above entity is wholly controlled from Mauritius, it will be Non -Resident of India in all the cases.

Control and management means *de facto* (actual) control or management, not merely the right to control or manage. Place of control and management is situated where the decision making of the entity as a whole is situated.

### 3.6. Residential Status of a Company –Section 6(3)

A company will be resident of India in any previous year, if—

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

"Place of effective management" means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made.

From the above, it follows that :-

- 1 Residential status of a company is based on its place of registration and control and management.
- 2 An Indian company will be resident in India irrespective of where their control or management is.
- 3 Any other company (i.e. a foreign company) will be a Resident in India if place of effective management (POEM) of such company is situated in India.
- 4 A foreign company will be non-resident will be resident if their control and management is wholly in India if place of effective management (POEM) of such company is situated outside India.

The legal provisions are summarised in the following table.

<b>Company</b>	<b>Status</b>
Indian company	Resident
Foreign company - POEM situated in India	Resident
Foreign company- POEM situated outside India	Non resident

#### Illustrations

1. Residential status of A Ltd., which is an Indian company managed from India is resident in India. Place of management is immaterial.
2. Residential status of, B Ltd., an Indian company managed from London, will also be Resident in India. Place of management is immaterial,
3. Residential status of C Ltd., which is a British company managed from India, will be resident in India as its POEM is situated in India.
4. Residential status of D incorporated, which is an American company managed from Paris, will be a Non-resident in India as its POEM is wholly situated outside India.

### **3.7. Miscellaneous:**

#### **(a) Residential status for each previous year:**

Residential status of a person shall be determined for each previous year independently.

#### **(b) Different residential status for different assessment years:**

Residential status may change from previous year to previous year and a person may have different residential status for different assessment years. For instance, if a person leaves India for two years and then comes back, he can be non-resident for those two years and resident for other years.

#### **(c) Resident in India and abroad:**

A person may be “resident” in two or more countries in a particular year. Similarly, in a particular assessment year, a person may be a non-resident in India as well as other countries.

In other words, it is not necessary that a person, who is “resident” in India, will necessarily be non-resident in all the other countries for the same assessment year.

This is particularly true of a person, who has changed his country two three times in a year and he does not fall in any category of residents anywhere in the world.

#### **(d) Residence for all sources:**

If a person is a resident for one source of income in a previous year, he shall be deemed to be a resident for all other sources of income also. [Section 6(5)]

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## **4. RESIDENTIAL STATUS AND INCIDENCE OF TAX**

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Provisions of section 5, which defines the scope of total income taxable in India, are given below.

### **4.1. Scope of total income for a Resident**

As per section 5(1), the total income of any previous year of a person, who is a resident, includes all income from whatever source derived which—

- (a) is received or is deemed to be received in India in such year by or on behalf of such person ; or
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or
- (c) Accrues or arises to him outside India during such year.

### **4.2. Person not ordinarily resident in India**

Total income of a person, who is not ordinarily resident in India within the meaning of Section 6(6), shall not include the income which accrues or arises to him outside India unless it is derived from a business controlled in or a profession set up in

India. Thus the Income of such person shall include the following income from whatever source derived which—

- (a) is received or is deemed to be received in India in such year by or on behalf of such person ; or
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or
- (c) accrues or arises to him outside India during such year if such income is derived from a business controlled in or a profession set up in India

#### **4.3. person who is a non-resident**

As per Section 5(2), the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

- (a) is received or is deemed to be received in India in such year by or on behalf of such person; or
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Thus the total income of a non-resident shall not include accrues or arises to him outside India during such year.

#### **4.4. Important points**

(a) Incidence of tax on a taxpayer depends on:-

- the residential status, and
- the place and time of accrual or receipt of income.;

(b) Income accruing or arising outside India shall not be deemed to be received in India by reason only of the fact that it is considered in a balance sheet prepared in India.

(c) Income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

(d) Indian income will be taxable in all cases. Indian income or Income received, accruing or arisen in India or deemed to be received, accruing or arising in India will be included in the income of every person regardless of his residential status whether resident , non-resident, or R & OR or R & NOR.

(e) Income may be “ Indian income” in a previous year if :-

- Income is received or deemed to be received in India and such income is also accrued or arisen or deemed to be accrued or arisen in India;
- If income is received or deemed to be received in India BUT it accrues or arises outside India; or
- If income is received outside India but it accrues, arises, or is deemed to accrue or arise in India.

(f) “Foreign income” or income, which is not Indian Income or Income not received, accrued or arisen in India nor deemed to be received, accrued or arisen in India is taxable as under:-

- I. Foreign income is not included in the total income of a non-resident,
- II. Foreign Income is included in the total income of a resident and ordinarily resident,
- III. Foreign income will not be included in the total income of a resident but not ordinarily resident R&NOR unless such income is derived from:
  - a business controlled in India or
  - A profession set up in India

Non-business foreign income will not be included in the income of a person who is resident but not ordinarily resident in India.

Thus foreign income taxable only by a R&OR and conditionally by R&NOR

(g) Under section 7 some incomes are deemed to be received in India e.g. Transfer balance of PF. Similarly, As per Section 9, certain incomes are deemed to accrue or arise in India even though they may actually accrue or arise outside India e.g. income attributable to any business connection in India or any property in India or any asset or any source of income in India or the transfer of a capital asset situated in India. Hence, rent from an Indian building or dividend of shares of an Indian company will be deemed to accrue in India.

(h) Residents are liable in respect of all income Indian or foreign but Non- residents liable for Indian income only

(i) The “receipt” of income refers to the first occasion when the recipient gets the money under his control. Once an amount is received as income, any remittance or transmission of the amount to another place does not result in “receipt” at the other place.

(j) It is not necessary that an income should be actually received in India in order to attract tax liability. An income deemed to be received in India in the previous year is also included in the taxable income of the assessee. The Act enumerates the certain incomes which were dealt with earlier. E.g. If a resident holds an immovable property in Delhi and the rent received thereon is transferred to his bank account in Mauritius, the rent would still be subject to income tax though the income has not been received in India.

(k) Income is said to be received when it reaches the assessee; when the right to receive the income becomes vested in the assessee, it is said to accrue or arise.

(l) Section 8 deals with tax treatment of dividend. As per the section final dividend is taxable on the date of AGM when it was declared. Interim and deemed dividend are taxable on the date of distribution.

**Summary :**

<b>Scope of total income –Section 5</b>			
Income	Status		
	Resident & Ordinarily Resident	Resident & Not Ordinarily Resident	Non Resident
Indian income	Taxable	Taxable	Taxable
Foreign income	Taxable	Taxable if income is from <ul style="list-style-type: none"> <li>• a business controlled from India or</li> <li>• a profession set up in India</li> </ul>	Not Taxable

**Illustrations**

1. Determine the scope of total income in respect of the following incomes if the assessee is a (1) resident or (2) a resident and ordinarily resident or (3) a resident but not ordinarily resident:

Income	Rs
Interest from U.S. Bonds received in India	80,000
Interest from U.S. Bonds received in U.S.	80,000
Interest from U.S. Bonds received in U.S but remitted to India	80,000
Capital gain on house in Mumbai sold in London	80,000
Capital gain on house in Mumbai sold in Mumbai	80,000
Rent of a villa in Paris received in Paris	80,000
Rent of a villa in Paris received in Mumbai	80,000
Agricultural Income from Tea Gardens in Nepal received in Nepal	80,000
Agricultural Income from Tea Gardens in Sri Lanka received in Mumbai	80,000
Profit from a Branch in Sydney	80,000
Profit from a branch in Mumbai	80,000
Salary for working in Pune received in Pune	80,000
Salary for working in Pune received in London	80,000
Salary for working in London received in Mumbai	80,000
Salary for working in London received in London	80,000



**Solution**

Particulars	R&OR	R&NOR	N R
Interest from U.S. Bonds received in India	80,000	80,000	80,000
Interest from U.S. Bonds received in U.S.	80,000	-	-
Interest from U.S. Bonds received in U.S but remitted to India	80,000	-	-
Capital gain on house in Mumbai sold in London	80,000	80,000	80,000
Capital gain on house in Mumbai sold in Mumbai	80,000	80,000	80,000
Rent of a villa in Paris received in Paris	80,000	-	-
Rent of a villa in Paris received in Mumbai	80,000	80,000	80,000
Agricultural Income from Tea Gardens in Sri Lanka received in Sri Lanka	80,000	-	-
Agricultural Income from Tea Gardens in Sri Lanka received in Mumbai	80,000	80,000	80,000
Profit from a Branch in Sydney	80,000	80,000	-
Profit from a branch in Mumbai	80,000	80,000	80,000
Salary for working in Pune received in Pune	80,000	80,000	80,000
Salary for working in Pune received in London	80,000	80,000	80,000
Salary for working in London received in Mumbai	80,000	80,000	80,000
Salary for working in London received in London	80,000	-	-
Total	12,00,000	8,00,000	7,20,000

\*if controlled from India

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## **4. HEADS OF INCOME- sections 14/14A**

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### **4.1. Classification of income**

Aggregate income from all sources is liable to Income tax. However, the income has to be classified under different heads of income according to its nature as the income tax law provides for specific treatment, rules and method for computation of income for each head of income. Section 14 gives 5 heads of income for classification of income. Namely:-

- 1) Income under the head salaries -Section 15 – 17
- 2) Income from house property-Section 22 – 27
- 3) Profits & gains from business or profession -Section 28 – 44
- 4) Capital gains-Section 45 – 55
- 5) Income from other sources-Section 56 – 59.

### **4.2. Importance of different heads**

The law provides different scheme for computation of taxable income under that head. This comprises of deeming provisions, exclusions and deductions and deductions of expenses etc. under the head.

### **4.3. Heads to be mutually exclusive**

It is imperative that income is computed under the specified head only. If any income is considered under a particular head e.g. Income from house property, it will not be taken into consideration for another head e.g. Profits and Gains from business and profession.

However, an income, not falling under any of the first four heads, will be taxed under the head “Income from other sources”.

### **Illustration**

Three offices are compositely let out on rent by along with services like intercom, security guard, telephone connection, furniture and fixtures, etc. of Swayam will be taxable.

As per departmental clarification, the income in respect of properties should be taxed as “Income from House Property” and the income out of rentals of the other services to be taxed under “Income from Other Sources”.

Alternatively, the entire income arising out of the property as well as the services could be taxable as “Income from Business or Profession”

### **4.4. Tax on aggregate income under all the heads**

Aggregate of income under all the five heads will be the gross total income of the assessee, from which deductions are made under chapter VIA. The net result is called the total income or sometimes taxable income, which is subject to tax at the prescribed rates, except in case of income for which different

rates are given. E.G. Long term capital gains on securities taxable now at 10% and on other assets at 20%, short-term capital gain on sale of equity shares at 15%, income from lotteries, horse races etc. at the maximum rate of tax @ 30%. Such income will be deducted from the aggregate total income and the balance of the total income will be taxable at prescribed rates.

#### **4.5. Common residential status for all the heads**

As per section 6 a person is resident for the purpose of any particular head of income, will also be considered as resident for the purposes of computation of income under all the heads of income.

#### **4.6. Separate sources of income under one head.**

A particular head of income may have different sources of income falling under that head. For instance a person may be in receipt of his salary from more than one employer or rent from two or more house properties or more than one business. All such sources will be clubbed together to arrive at the income from that head.

#### **4.7. Expenses under each head of income**

It may be noted that expenses may be allowed under each head of income according to the provisions applicable. The recent trend is to restrict and standardize the allowance of expenditure. For instance no expenses except professional tax are allowed under the head salaries. Capital gains envisage deduction if only the cost of acquisition and improvement and transfer expenses and so on and so forth.

#### **4.8. Expenditure incurred in relation to income not includible in total income**

Section 14A provides that no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to exempted income that is the income which does not form part of the total income under this Act

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## **12. SELF ASSESSMENT QUESTIONS:**

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1. Why determination of residential status is important to ascertain the income tax liability?
2. Discuss the legal provisions in respect of residential status of an individual.
3. Briefly state the provisions for determination of the residential status of an (a) AOP (b) Firm (c) Company.
4. What is meant by the control and management of business?
5. When the income is deemed to accrue or arise or be received in India?
6. The incidence of income-tax depends upon the residential status of an assessee". Discuss.

7. Determine whether the following is true or false:
8. The business income received by X Ltd. an Indian company in New York is foreign income of X.
9. The dividend received from a foreign company in India is Indian Income
10. Write short notes on the following:
  - a. Income received in India
  - b. Income deemed to accrue or arise in India
  - c. Control and management of a business
11. Enumerate various heads of income.
12. State with reason that can an Income be computed under two heads of income.
13. How are the different heads mutually exclusive?
14. Would expenses in respect of collection of dividend be deductible from income from other sources?
15. Ascertain residential status for the assessment years 2017-18 and 2018-19, of Turner an Australian citizen, came to India as a commentator during the following period:

From	To	Purpose
10.2. 2017	20-04-2017	World Cup
6-10-2017	25-12-2017	England Tour
04-01-2018	12-01-2018	Training Camp
02-03-2018	29-03-2018	Triangular Cup

Besides, Turner was in India for 340 days in four previous years from 2012-13, to 2016-17 260 days in three previous years from 2011-12 to 2013-14.

(Ans: 2015-16 Non-residents, 2014-15 R but RNOR)

16. Determine the residential status of Pandya, who made his debut in international cricket on 11/03/2009. In the first match, he was injured and had to be hospitalized. In U.S. He was discharged from the hospital on 29/03/2010. He returned to India took over as coach for Indian cricket team visiting Pakistan. Parthiv submits the following details of his stay outside India :

From	To	Purpose/ Place
10-04 2017	28-04-2017	World Cup in Dhaka
03-05-2017	09-07-2017	England Tour
27-08-2017	10-09-2017	Canada Tour
11-09-2017	01-10-2017	US holidays
04-01-2018	26-03-2018	Pakistan Tour

(Ans: Non-Resident)

17. Ashok, an Indian citizen, leaves India on May 22, 2012 for vacation to Uganda and returns on April 9, 2018. Determine the residential status of X for the assessment year 2018-19?  
(Ans: Non-Resident)

18. Determine the residential status for the assessment year 2018-19, of Sheila, a foreign citizen, who visits India since 1985 every year for a period of 100 days  
(Ans: Non-Resident)

19. Fletcher, a foreign citizen comes to India, for the first time on March 20, 2015. On September 1, 2015, he leaves India for Nepal on a business trip. He comes back on February 26, 2018 to permanently stay in India. Determine the residential status of X for the assessment year 2017-18 and 2018-19  
(Ans Resident and Not Ordinarily Resident for both the years)

20. Determine residential status for the assessment year 2018-19 of Marconi, an Italian citizen, who comes to India for the first time on May 28, 2016.  
(Ans: Resident and Not Ordinarily Resident)

21. Determine the scope of total income in respect of the following incomes if the assessee is a (1) resident or (2) a resident and ordinarily resident or (3) a resident but not ordinarily resident

New York business income controlled from India	Rs. 100000
Mumbai Business Controlled from Paris	Rs. 40000
Salary in New York as Indian ambassador	Rs. 90000
Profit on sale of shop in Kolkata paid in Karachi	Rs. 50000
Acting in Indian film –fee received in Rome	Rs. 70000
Past untaxed profits remitted to India from London	Rs. 120000

(Ans. Resident 350000, R & OR 250000, R& NOR 350000/ past profits not taxable)

22. Blair, a French Citizen had the following incomes during the year ended 31/3/2018. Compute his Total Income for Asst. Year 2018-19 if he is a (1) resident or (2) a resident and ordinarily resident or (3) a resident but not ordinarily resident.

Income from House property in India	Rs. 30000
Income from property in Rome	Rs. 20000
Interest from Bank account in India	Rs. 2400
Income from business in Bangladesh controlled from India	Rs.32000
Interest from Bank account in U.S.	Rs. 22000
Salary earned and received in Tokyo	Rs. 24000
Income earned and received in London	Rs. 26000
Dividend from British Company received in India	Rs.34000

(Ans. Resident 19400, R&OR Rs. 98600 R but NOR Rs 66400)

23. Following are the particulars of income of X for the previous year 2017-18:

- i. X is employed in India and receives Rs. 24,000 as salary.
- ii. Dividend received in London on June 3, 2017: Rs. 31,000 from a foreign company;
- iii. Share of profit received in London on December 15, 2017 from a business situated in Sri Lanka but controlled from India:
- iv. Rs. 60,000; remittance from London on January 15, 2018 out of past untaxed profit of 2003-04 earned and received there: Rs. 30,000 and interest earned and received in India on May 11, 2018 Rs. 76,000.

Find out his gross total income, if he is (a) resident and ordinarily resident, (b) resident but not ordinarily resident, and (c) non-resident for the assessment year 2018-19

(Ans: R&OR, his gross total income will be Rs. 105000 i.e. Rs. 24,000 + Rs. 31,000 + Rs. 60,000 R& N OR Rs. 84,000 i.e., Rs. 24,000 + Rs. 60,000). Non-resident, Rs.24,000.

The remittance from London of Rs. 30,000 is not taxable it is not "receipt" of income. The interest of Rs. 76,000 earned and received in India is taxable 2015-16. )



## **SALARIES**

### **(Sections 15, 16 & 17)**

#### **Synopsis**

1. Introduction and Objectives
2. Basis of Charge
3. Meaning and characteristics
4. Scope of salary income
5. Tax Treatment of some receipts:
6. Taxable Value of cash allowances-
7. Taxable Value of Perquisites
8. Classification of Perquisites
9. Valuation of Perquisites
10. Profits in lieu of Salary
11. Deductions -Entertainment Allowance, Profession Tax
12. Practical illustrations
13. Self- Assessment Questions

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### **1. INTRODUCTION AND OBJECTIVES:**

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This lesson explains “Salaries” the first and most important of the five heads of income given in section 14. Under the tax laws, concept of “Salaries” is very wide and includes not only the salary in common parlance but also various other receipts, gifts, perquisites and benefits.

The lesson deals with various provisions what constitute salaries and other relevant matters like salary, types of allowances, perquisites and benefits and their valuation for tax along with the applicable legal provisions contained in sections 15,16 and 17, while computing the income from salary and explain the terms.

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### **2. BASIS OF CHARGE AND MEANING- Sec 15**

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#### **2.1. Basis of charge**

Section 15 provides the basis of charging salary income and section 17 explains it. Section 16 prescribes the deductions to be made from salary income.

Section 15 provides that the following income shall be chargeable to income tax under the head "Salaries"—

- (a) any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not;
- (b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;
- (c) any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

Thus, the term salary embodies of past (arrears), present and future salary (Advance). However, where any salary paid in advance is included in the total income of any person for any previous year, it shall not be included again in the total income of the person when the salary becomes due.

Further, any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner from the firm shall not be regarded as "salary" for the purposes of this section because it is considered as business income u/s 28.

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### **3. Meaning and Characteristics**

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Section 15 states that salaries –past, present and future will be taxable under the head “salaries”. It does not define salaries. Hence, it becomes necessary to determine, whether any particular income is to be taxed under the head “Salaries” or not with the help of common practices, tests, norms, judicial decision developed over the years. These are discussed in detail as under: -

#### **1. Employer-employee relationship:**

Salary is the remuneration paid by an employer to an employee for rendering personal services to the employer under an expressed or implied contract for rendering such services. From the definition the term salary implies the existence of the following conditions. Hence, by an express or implied contract for employment, two parties the employer and the employee. The employee provides of personal services to the employer for remuneration.

#### **2. Compensation for services rendered :**

Salary is paid as a compensation for the services rendered as an employee and not in any other capacity. E.g. Remuneration paid by a hospital to a doctor employee for taking care of the patients in that hospital will be salary, but the services rendered by that doctor to patients in his private clinic will not be salary as he is not an employee of the patients. Payment received from patients will not be salary but his professional income.



It will be true of services rendered by other professionals like doctors, architects; lawyers, Chartered Accountants etc. to their clients and the fee paid by their clients will be professional fees not salary.

### **3. Name or form not important:**

Any remuneration paid as compensation for services rendered by an employee to his employer will be treated as salary regardless of name given such as salary or wages or otherwise so long as -

- the relationship between the payer and payee is that of employer and employee; and
- the payment is made as a compensation for the services rendered by the employee
- Under Section 17, salary includes payment made in other forms like gift, perquisites etc.

### **4. . Mode of Payment**

Salary may be paid in cash or kind.

### **5. More than One Source :**

Salary may be from more than one employers.

### **6. Type of Employment:**

Salary may be in any capacity like part-time employment or full time employment.

### **7. Past, Present and prospective employer**

Salary may be received from not just the present employer but also a prospective employer and in some cases even from a former employer for example pension received from a former employer.

### **8. Real intention to pay :**

Salary income must be real and not fictitious. There must exist an intention or an obligation to pay and `receive salary.

### **9. Subsequent Surrender of Salary not tax-free;**

Salary is taxed on due basis. A subsequent surrender of the salary will not be tax-free except where an employee surrenders his salary to the central government, and then the salary so surrendered will not be treated as taxable income of the employee.

### **10. Tax- Free salary**

Salary paid as tax-free is also taxable in the hands of the employee, though contractually income tax on such is borne not by the employee but by the employer.

### **11. Time of taxability;**

Method of accounting employed by the employee is not relevant to determine the taxability of salary. Which is taxable at

the time of accrual/ actual earning or receipt, whichever is earlier. Hence :-

- Current salary is taxable when it is accrued although it may be payable later.
- Past salary or arrears are taxable, when they are actually received, if they were not taxed earlier.
- Advance salary is taxable at the time of receipt and it will not be taxed again when it is accrued.

## **12. Salary received by individuals only**

Salary is taxable in the hands of individuals only because it is a compensation for personalised services, which can obviously be rendered by a normal human being only. No other type of person such as a firm, HUF, company or a body corporate can earn salary.

## **13. Voluntary payments taxable as salary**

Voluntary payments like gift by an employer to an employee also form the part of taxable salary.

## **14. Salary in respect of services rendered in India**

Under section 9 salary, leave salary and pension paid outside India are deemed to accrue and arise in India and are taxable in India. Similarly, salary paid to Indian diplomats by the Government of India is deemed to accrue and arise in India although the same is exempted u/s 10.

## **15. Gross salary Taxable;**

Compulsory deductions from salary such as employees' contribution to provident fund, deduction for medical scheme or staff welfare scheme etc. are examples of instances of application of income. In these cases, for computing total income, these deductions have to be added back in the net salary received and gross salary will be taxable.

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# **4. SCOPE OF SALARY INCOME- SECTION 17**

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**4.1.** Section 15 defines the scope and basis of salaries and section 17 explains it in an inclusive definition.

Salary includes:-

- a. Wages;
- b. Any Pension or Annuity;
- c. Any Gratuity;
- d. Any fees, commission, perquisites or profits in lieu of or in addition to salary or wages;
- e. Any advance of salary;
- f. Any encashment of leave salary;
- g. Annual accreditation to provident fund above the prescribed limits; and
- h. Any amount of credit to provident fund of employee to the extent it is taxable.

**4.2.** "Salary" includes the basic salary and fees, commission, bonus, taxable value of cash allowances and perquisites, retirement benefits, encashment of leave salary, advance of salary, arrears of salary, various allowances such as dearness allowance, entertainment allowance, house rent allowance, conveyance allowance, value of perquisites by way of free housing, free car, free schooling for children of employees, etc.

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## **5. TAX TREATMENT OF SOME RECEIPTS**

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### **5.1. Basic Salary**

Basic salary is the amount of salary fixed as per the terms of employment. It may be a pre-determined fixed sum, or a graded amount enhanced by pre-fixed annual increment. Under the graded system, the terms of employment fix the salary at say Rs.10000-200-15000-500-20,000. The starting salary of the employee will be Rs 10,000 , which will be raised by Rs 200 to Rs. 10,200 in the next year and so on till he reaches he reaches the level of Rs 15,000 p.m. Thereafter, the annual increment will be Rs 500 per annum till he reaches level of Rs 20,000 p.m. After reaching the level of Rs 20,000 p.m., increment will not be given, unless he is promoted and placed in other grade.

### **5.2. Fees, Commission and Bonus**

Any fees, commission, bonus, or incentive paid or payable to an employee by an employer is taxable and is included in salary. Such Commission etc. may be payable as a fixed amount or as a percentage of turnover or partly fixed and partly as a percentage of turnover. When commission is based on fixed percentage of turnover achieved by employee, it is included in basic salary for the purpose of grant of retirement benefits and for computing, certain exemptions discussed later

### **5.3. Arrears of salary:**

Arrears of salary are taxed on receipt basis, if the same has not been taxed earlier. However, the employee will be entitled to claim relief u/s 89 in respect of such arrears.

### **5.4. Advance Salary:**

Salary received in advance is taxable on receipt basis. There will be no tax again in the year in which the salary actually accrues. The employee can claim relief u/s 89 in respect of advance salary. However, advance or loan against salary will not be taxable.

### **5.5. Gratuity - Section 10(10):**

Gratuity is a lump-sum payment to reward an employee for his past services, on his retirement or termination. Amount received as gratuity on termination is exempt u/s 10(10) as under:-

- 1 Employees of Central or State governments or local authorities fully exempt

- 2 Employees in a concern covered under the Payment of Gratuity Act, 1972 is exempt subject to the lowest of the following amounts :

- a. Amount of gratuity received,
- b. Rs 10,00,000
- c. 15 days' salary for every completed or part thereof in excess of six months, year of service computed based on last salary drawn taking numerator of 26.

$$\frac{*Completed\ year\ of\ service \times 15\ days \times Last\ Drawn\ Salary}{26}$$

- 3 Employees in a concern not covered under the Payment of Gratuity Act, 1972 is exempt subject to the lowest of the following amounts :

- a. Amount of gratuity received,
- b. Rs 10,00,000
- c. Half month's salary for every completed year of service in excess of six months (ignoring the fraction) computed based on average salary of last 10 months preceding the retirement.

$$*Completed\ year\ of\ service * \frac{1}{2} * Avg\ Salary\ for\ last\ 10\ months$$

[\*Completed year of service includes a year or part thereof in excess of six months]

### Illustrations

ABC retires from service on 1<sup>st</sup> June 2018 after 22 years and 9 months' service. He receives gratuity of Rs 15,00,000. Determine the amount of exemption of gratuity if he was drawing a basic salary for 10 months preceding the month of his retirement at Rs 40,000 p.m. The exemption will be as follows :-

- (a) If ABC is a government employee, gratuity is fully exempt u/s 10(10).
- (b) if ABC was working with ABC Limited, covered under the Payment of Gratuity Act, 1972, then the exempted gratuity will be as Rs 5,30,769 worked out as under

I. Actual amount received	15,00,000
II. Notified amount	10,00,000
III. 15-day's salary based on last drawn salary Rs.40, 000* 15/26 *23 years	5, 30,769
Taxable	9,69,231

- (c) If ABC Limited is not covered under the Payment of Gratuity Act, 1972, then the exempted gratuity will be only Rs 4,40,000 as worked out below :-

I. Actual amount received	15,00,000
II. Notified amount	10,00,000
III. 15-day's salary based on last drawn salary Rs.40, 000 X (11) = 23*0.5 -fraction ignored)	4,40,000
Taxable	10,60,000

### 5.6. Commuted Pension (Section 10(10A) :

Pension is a regular payment made at monthly or annual intervals by an employer to his employee on retirement his retirement of an employer as a reward for his past services. When an employee is allowed to forgo a portion of pension in lieu of a lump sum amount called commutation of pension. Tax treatment of these two kinds of pension is as under:

- a) Regular payment of pension, monthly or quarterly or at some other interval, periodical or uncommuted pension *is fully* taxable in the hands of all employees, whether government or non-government.
- b) Lump sum payment received by an employee on commutation of pension as per service rules will be-
  - i. fully exempt for employees of the Central or State Government or a Local Authority or a Statutory Corporation
  - ii. partially exempt for other employees to the extent of -
    - a. *One half of the total value* of pension If the employee has not received any gratuity on termination of employment, and
    - b. *One-third of the total value* of pension, if the employee has received any gratuity on termination of employment.

### Illustrations

1. If A receives a monthly pension of Rs 50,000 from the Government, it will be fully taxable.

2. In the above illustration, the pension is received from a private employer, then also it will be fully taxable. It is immaterial who the employer is.

3. A retires from government service on 01/06/2017. He receives a pension of Rs 6000 p.m. till 31/12/2017. On 01/01/2018, A opts for commutation of 40 per cent of the value of his pension for a lump sum amount of Rs 1,60,000. After commutation, A gets Rs 3,600 per month being 60% of the total pension. Determine the taxability of pension if no gratuity is paid to A.

- a) Lump sum amount of Rs. 1,60,000 received on commutation of pension will be exempt as A is a government employee

- b) Regular pension Received during F.Y. 2017-18 Rs. 52,800 will be fully taxable

01/06/2017 to 31/12/2017@ Rs 6,000 P.M	= Rs. 42,000
01/01/2018 to 31/03/2018 @ Rs 3600 p. m	= Rs. 10,800
<b>Total</b>	<b>Rs. 52,800</b>

4. What will be the position in the above illustration if A is a private employee?

Commutation of Pension	Rs.
Amount Received on commutation of 40% of salary	1,60,000
Full Value of Pension = 1,60,000 /40%	4,00,000
Amount Received on commutation	1,60,000
$\frac{1}{2}$ of full value of pension Rs 4,00,000* $\frac{1}{2}$	2,00,000
Exempted Amount - being the lower of the two	1,60,000
Taxable Amount	NIL

Regular pension of Rs 52.800 will be taxable irrespective of the fact that A is government employee or a private employee or whether or not he is in receipt of any gratuity.

5. In the above illustrations, ascertain the taxability if A also receives Rs 50,000 as gratuity.

**Solution:**

- Regular pension of Rs. 52.800 fully be taxable in all cases.
- If A is a government employee, the amount received on commutation of pension will be fully exempt regardless of the fact that he also receives gratuity.
- If A is a non- governmental employee and is in receipt of gratuity and he receives Rs 1,60,000 on commutation, he will be entitled to exemption of Rs 1,33,333 being  $\frac{1}{3}$  of full value of pension ( $\frac{1}{3}$  of Rs 4,00,000). Balance Rs 27,667 will be taxable.

**5.7. Encashment of Leave Salary {Section 10(10AA)}**

When an employee, instead of enjoying leave at his credit, gets the same encashed, following tax treatment will be given:-

- Amount received on encashment of leave during the *continuity of employment by all the employees*, will be *taxable* in the year of receipt. However, the employee will be entitled to relief u/s 89.
- Amount received on encashment of leave at the time of retirement by way of *superannuation* or otherwise, will be-
  - fully exempt in case of an employee of the Central or State Government;* and

ii. Partially exempt in case of any other *employee including employees of a local authority or a statutory corporation* to the extent of the lowest of the following and only the balance will be taxable:-

- i. Actual amount received
  - ii. Notified Amount currently Rs 3,00,000;
  - iii. 10 months' average salary or
  - iv. Cash equivalent of leave to be encashed
- i.e. (Leave Entitlement - Leave Availed) X Average Salary

Following points are important in this regard:

- (a) Salary for the purpose of calculating the exempt leave encashment means total of basic salary, dearness allowance and commission on sales achieved by salesmen.
- (b) Average salary means average salary of 10 months immediately preceding the retirement.
- (c) Leave entitlement is to be taken at 30 days for each completed year of service. *Part of the year will be ignored and not considered as completed year of service.*
- (d) If leave is encashed from more than one employer, the exemption limit will be taken in respect of all the employers.
- (e) Superannuation means retirement on attaining a certain age e.g. 60 years. Courts have held that termination and even resignation of the employee will entitle them to exemption under this section.
- (f) Leave to the credit of the employee means total leave available as reduced by total leave availed.

### Illustrations

1. A retires from his job with the Government of Goa on 01/06/2017 after rendering services for 22 years and 9 months. He was drawing a basic Salary for 10 months preceding the month of his retirement at Rs 10,000 p.m. Besides, he was entitled to 2 months' leave for every year of service or part thereof. A availed total earned leave of 10 months. He encashed unavailed leave for Rs 3,60,000 i.e. 36 months @ Rs 10,000 p.m. worked out as :

Leave entitlement - 23 years @ 2 months 46 months for every year of service or part thereof less -leave availed 10 months = 36 months.

Since A is a government employee amount, received as leave encashment on retirement is fully exempt U/s 10(10AA).

2. If A was employed with MKCL, a statutory corporation not regarded as government. Exemption would be at par with a

private employee as statutory corporation is nor Government.  
Exemption will be as under :-

	Rs.
Amount Received on leave encashment	3,60,000
Notified Amount	3,00,000
10 months' average pay@ Rs. 10,000 p.	1,00,000
Encashment of unavailed leave <i>12 months</i>	1,20,000
Exempted Amount - being the lower of the two	1,00,000
Taxable Amount [3,00,000- 1,00,000]	2,00,000

*\*Leave entitlement – 22 months – Leave availed 10 Months ignoring fractional period of service of 9 months as it is not rounded off.*

3. What will be the exempt amount if A receives the leave encashment while in service?

### **Solution**

Leave encashment during continuance of employment is fully taxable regardless of who the employer is .

### **Retrenchment compensation –S.10 (10B)**

Any compensation received by a workman at the time of retrenchment or closure or transfer of undertaking including change of management resulting in interruption of service is exempt fully if it is paid under a scheme of closure approved by the central government and in other cases, least of the following amounts would be exempt:

- Notified amount, presently Rs. 5,00,000
- 15 days' average pay for every completed year of service or any part thereof in excess of six months
- Actual amount.

### **Other points;**

- Compensation under a Voluntary Retirement Scheme is also exempt u/s1010C.
- Where an assessee has to pay higher tax on account of such lump sum receipts, he is entitled to relief u/s 89.
- If an assessee claims exemption under this section, then he can not claim relief u/s 89[1].

### **Illustration**

A workman was retrenched after 20 year and 10 months service His average salary was Rs 10,000 per month. He was paid Rs 1,40,000 as the retrenchment compensation. Calculate the exempt amount.



**Solution**

The exempt amount will be least of the following:

	Rs.
Actual Amount Received	1,40,000
Notified Amount	5,00,000
#10-1/2 months' average salary	1,05,000
Rs 10,000 per month	
Exempted ( Lowest of the above	1,42,500
Taxable 1,40,000-1,05,000	35,000

*#(15 days for 20 years and 10 months rounded off to next number. Relief u/s 89 not available if he claims the above exemption.*

**5.8. House Rent Allowance (Section 10-13A)**

House Rent Allowance or HRA paid by the employer to the employee to meet the housing expenses of the employee, is exempt from tax U/s 10(13A) being the least of the following :

- HRA actually received.
- Rent paid by employee in excess of 10 per cent of salary during the previous year.
- 50 per cent of salary, if employee is residing in the 4 metro cities of Mumbai, Delhi, Chennai or Kolkata and 40 per cent of salary, if the employee is residing at any other place.

Salary for the purpose of calculating the amount of deduction from HRA means the aggregate of Basic Salary, Dearness Allowance and Commission received by salesman on sales achieved by him but it does not include other receipts such as overtime pay, conveyance allowance, etc.

In simple words, so long, the rent paid is upto 10% of the salary, no HRA will be exempt. It is only if the rent paid is more than 10 %, then the actual HRA may be exempt to the extent of 40% or 50% of the salary.

**Illustrations**

1. For an employee residing in Delhi, who is in receipt of basic salary- Rs. 60,000, Dearness allowance-Rs. 30,000 and HRA-Rs 35,000, exemption of HRA will be the least of the following assuming he paid rent - Rs 15,000 per annum.

	Rs.
Actual HRA Received	35,000
Rent paid in excess of 10 % of salary	6,000
15,000- {10 %( 60,000+30,000)}	
50% of salary	45,000
Exempted ( Lowest of the above)	6,000
Taxable 35,000-6,000	29,000

2. Exempt amount If rent paid is -Rs. 50,000 :

	Rs.
Actual HRA Received	35,000
Rent paid in excess of 10 % of salary	41,000
50,000- {10 %( 60,000+30,000)}	
50% of salary	45,000
Exempted ( Lowest of the above	35,000
Taxable	NIL

3. Exempted HRA for an employee be based in Pune :

	Rs.
Actual HRA Received	35,000
Rent paid in excess of 10 % of salary	41,000
50,000- {10 %( 60,000+30,000)}	
40% of salary	36,000
Exempted ( Lowest of the above)	35,000
Taxable	NIL

*Note - The time and notified amounts, wherever applicable in this lesson, are technically not in syllabus but given to keep the text logically complete. These should be available in question.*

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## 6. TAXABLE VALUE OF CASH ALLOWANCES:

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Most employers offer allowances or fixed monetary amounts to the employees over and above basic salary normally paid to meet some personal expenses like house rent, conveyance etc. or for performance of his duties such as entertainment or telephone allowance or partly for personal and partly for official purpose.

All such allowances are taxable and included in gross salary unless specific exemption is provided in respect of such allowance. Accordingly, the allowances are of four categories –

- Allowances, which are fully taxable;
- Allowances, which are wholly and unconditionally exempt,
- Allowance, which are tax-free or taxable subject to certain conditions or limits.
- Allowances, in respect of which exemption is allowed only for a sum prescribed on *ad hoc* basis.

Some of these allowances are dealt with as under :-

### 6.1. Allowances Fully Taxable :

- Dearness Allowance**, a compensatory allowance paid to meet high prices and increased cost of living.
- City compensatory allowance** also a compensatory allowance paid to employees posted in big cities like Delhi, Mumbai to compensate the high cost of living in such cities

- c. **Non- practicing allowance** normally paid to compensate professionals in government service like doctors, chartered accountants, engineers, scientists etc, who are prohibited from doing private practice,
- d. **Warden or proctor allowance** paid in educational institutions for working as a Warden of the hostel or as a Proctor in the institution,
- e. **Deputation allowance** paid to an employee sent from his permanent place of service to some place or institute on deputation for a temporary period,
- f. **Overtime allowance** paid as extra wages paid to an employee putting in extra working hours over and above his normal hours of duty,
- g. **Servant allowance**, if paid in cash even if the employee may have employed servants.
- h. **Other allowances** by whatever name called such as family allowance, project allowance, marriage allowance, education allowance, holiday allowance etc. as these allowances are not specifically exempt.

## **6.2. Wholly and unconditionally exempt Allowances**

- a. Allowances paid to Judges of the High Courts and the Supreme Court,
- b. Allowances paid by the United Nations Organization to its employees.
- c. Foreign allowance paid by the government to its employees being Indian citizen posted out of India for rendering services abroad
- d. Pension to gallantry award winners like Paramvir Chakra, Mahavir Chakra, Vir Chakra etc - Section 10(18)

## **6.3. Wholly or partly tax-free Allowances:**

Following allowance are wholly or partly tax -free. Some of the exemptions are conditional. Most of the conditions and monetary limits, though prescribed in rules are incorporated in brief to make the subject comprehensive. Brief description of these allowances is as follows

### **a. Entertainment allowance- Section 16 (ii)**

Entertainment allowance the private sector employees for entertaining the business relations and clients of the employer is fully taxable by even if the entire amount may have been spent by them.

For the Government employees, the allowance is partially exempt by way of deduction u/s 16(ii) upto 20 per cent of basic salary, or Rs 5,000 per annum, whichever is lower. Full amount is first included in the salary and then the exempted amount is reduced.

**b. Fixed medical allowances**

Fixed medical allowance is taxable but reimbursement of medical expenses is exempt upto Rs 15,000

**c. Tiffin / lunch allowance**

Tiffin / Lunch Allowance paid in cash is fully taxable, but Cost of lunch provided to employees on their work place or even lunch coupons redeemable with restaurants is a tax-free perquisite subject to fulfillment of certain *conditions prescribed by the CBDT*.

**d. Transport allowance- S. 10(14)**

Any allowance or benefit given to meet the expense wholly and necessarily in the course of employment is fully exempt u/10(14) subject to the assessee presenting the proof in this regard.

Under Rule 2BB, transport or conveyance allowance paid to meet conveyance expenses of the employee from place of residence to place of work and back is exempt upto Rs 1600 per month ( Rs 3,200 in case of a handicapped employee) .

For example, if A is in receipt transport allowance @ Rs 2,000 per month, Rs 400 per month (Rs 2000-Rs 1,600) will be included in total income of A

**e. Other allowances for official purposes-S 10(14) ;**

U/s 10(14) allowances (other than conveyance between residence and office) are exempt to the extent of amount actually spent from those allowances by the employee in meeting the official expenses.

For example, where an employee receives uniform allowance of Rs 10,000 and spends Rs 4000 on uniforms, then Rs. 4,000 actually spent will be exempt and unspent sum of Rs. 6,000 will be taxable in the hands of the employee.

Some other examples of the allowances paid for meeting expenses incurred exclusively in performance of official duties are travelling allowance, daily allowance, conveyance allowance, helper allowance, research allowance.

**f. Education allowance:**

Education Allowance given to meet the education expenses of the employee's is taxable in hands of employee. However, under rule 2BB a sum of Rs. 100 per month per child per year (Rs. 300 if the child stays in a hostel) subject to maximum of two children is allowed as exemption from such allowance received by the employee.

**g. Out of station allowance**

An allowance granted to an employee working in a transport system to meet his personal expenses in performance of his duty in the course of running of such transport from one

place to another is exempt upto 70% of such allowance or Rs.6000 per month, whichever is less.

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## 7. TAXABLE VALUE OF PERQUISITES

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### 7.1. Definition and Meaning of Perquisites:

Under section 17(2), value of perquisites allowed to an employee is chargeable to tax, but it does not define the term. In normal commercial parlance, perquisites denote any casual emoluments or benefits attached to an office or position in addition to salary or wages. Perquisites are normally allowed in kind - not in cash; and are measurable in monetary terms.

### 7.2. Taxability of perquisites:

Perquisites are included in taxable salary only if they are:

- allowed by an employer to an employee,
- allowed during the continuation of employment,
- directly dependent on service,
- resulting in personal advantage to the employee; and
- derived by virtue of employer's authority.

### 7.3. Taxable perquisites

Sec. 17 (2) provides the following list of taxable perquisites:

- i. Value of *rent-free accommodation* provided to the employee by the employer.
- ii. Value of *concession in rent* in respect of accommodation provided to the employee by his employer.
- iii. Value of any *benefit or amenity* granted free of cost or at a concessional rate in any of the following cases:
  - a) by a company to an employee who is a director thereof
  - b) by a company to an employee who has substantial interest in the company
  - c) by any employer to an employee who is neither a director, nor has substantial interest in the company, but his monetary emoluments under the head 'Salaries' exceeds Rs.50,000.
- iv. Any sum paid by the employer towards any obligation of the employee
- v. Any sum payable by employer to effect an assurance on the life of assessee
- vi. The value of any other fringe benefit given to the employee as may be prescribed.

### 7.4. Classification of Perquisites

As per section 17(2), perquisites are of three broad categories :

- Perquisites taxable in all cases
- Perquisites not taxable at all

- Perquisites taxable only in the hands of specified employees only

#### **A. Perquisites taxable in all cases:**

The following perquisites are taxable u/s 17(2) in the hands of all type of employees, whether specified or not:

- 1) Value of Rent free house provided by employer
- 2) Value of house provided at concessional rate
3. Any obligation of employee discharged by employer e.g. payment of club or hotel bills of employee, salary to domestic servants engaged by employee, payment of school fees of employees' children etc.
4. Any sum paid by employer in respect of insurance premia on the life of employee

#### **B. Perquisites, which are tax-free for all the employees**

Section 17 specifically states that the following will not be taxable in the hand of the employees :-

##### **a. Medical benefits within India :**

Exempted medical benefits within India, include:-

- i. Medical treatment provided to an employee or any member of his family in a hospital maintained by the employer.
- ii. Any sum paid by the employer in respect of any expenditure incurred by the employee on medical treatment of himself and members of his family:
- iii. In a hospital maintained by government or local authority or approved by the government for medical treatment of its employees.
- iv. In respect of the prescribed diseases or ailments in any hospital approved by the Chief Commissioner.
- v. If the ordinary medical treatment of the employee or any member of his family is done at any private hospital, nursing home or clinic, the exemption is restricted to Rs.15000.

##### **b. Medical benefits outside India**

Exempted medical Treatment outside India includes :

- i. Any expenditure incurred by employer on the medical treatment of the employee or any member of his family outside India.
- ii. Any expenditure incurred by employer on travel and stay abroad of the patient being the employee or member of his family and one attendant who accompanies the patient in connection with such treatment, shall be exempt to the following extent :

- (i) The expenditure on medical treatment and stay abroad shall be exempt to the extent permitted by the Reserve Bank of India.
- (ii) The expenditure on travel shall be exempt in full provided the gross total income of the employee (including this expenditure) does not exceed Rs.2,00,000.

**c. Medical Health Insurance within India**

Exempted perquisites in respect of medical Health Insurance include:-

- i. Premium paid by the employer on health insurance of the employee under an approved scheme u/s 36(1) (ib); and
- ii. Premium on insurance of health of an employee or his family members paid by employer on any scheme approved u/s 80D (Mediclaime).

**d. ESOP or Sweat Equity**

Any benefit provided by a company free of cost or at a concessional rate to its employees by way of allotment of shares, debentures or warrants directly or indirectly under any Employees Stock Option Plan or Scheme *ESOP/ESOS* of the company offered to such employees in accordance with the guidelines issued in this behalf by the Central Government. However, the difference between the fair Market Value and the issue price will be treated, when such equity is issued at concessional price, as the taxable perquisite value of ESOP

**e. Transport**

Amenity or benefit granted or provided free of cost or at concessional rate for use of any vehicle provided by a company or an employer for journey by the assessee from his residence to his office or other place of work, or from such office or place to his residence.

**f. Refreshments**

Refreshment provided by an employer to the employee during working hours in office environment.

**g. Others:**

- a. Value of Leave Travel Concession in India.
- b. Amount spent by the employer as its contribution to staff welfare schemes.
- c. Laptops and computers provided for personal use.
- d. Rent free official accommodation provided to a Judge of High Court or Supreme Court or an official of Parliament including Minister and Leader of Opposition in Parliament.

- e. Recreational facilities extended not to a particular employee but to a class of employees.
- f. Amount spent on training of employee or fees paid for refresher course.
- g. Telephone provided to an employee at his residence.
- h. Goods manufactured by the employer sold to employees at concessional rates
- i. Allowances to employees of UNO

The Fringe Benefits Tax (FB) has since been discontinued; value of cars and other perquisites will be taxable in the hands of the employees.

### **C. Perquisites taxable by specified employees only**

U/s 17(2) (iii) the value of any benefit or amenity granted or provided free of cost or at concessional rate specified employees only will be taxable. Specified employee means an employee who is-

- *a director* of the employer; or
- who has a *substantial interest* i.e. more than 20 % voting power in the company; where he is employed or
- any other employee (of any employer including a company) whose income under the head salaries *exceeds fifty thousand rupees*.

Salary for this purpose means salary due from, or paid or allowed by, one or more employers, exclusive of the value of all benefits or amenities not provided for by way of monetary payment,

The taxable perquisites are:-

1. Free supply of gas, electricity or water supply for household consumption;
2. Free or concessional educational facilities to the members of employee's household;
3. Free or concessional transport facilities;
4. Sweeper, watchman, gardener, personal attendant; and
5. Any other benefit or amenity

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## **7. VALUATION OF PERQUISITES:**

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Perquisites are benefits granted in kind. Hence, monetary value of the perquisites taxable in the hands of the employee is required to be determined. Broad principles for determining the value of taxable perquisites are stated as under:-



- a) The amount actually spent by the employer will be the taxable value of perquisite allowed entirely for personal benefits of the employee.
- b) Taxable value of the perquisite allowed to an employee for official purposes only shall be nil and perquisites will not be taxable in the hands of employee.
- c) Taxable value of the perquisites allowed partly for personal and partly for official purpose, will be an amount of perquisites reasonably used for personal purposes.

*Actual valuation rule are beyond the scope of the syllabus, only the general principles for valuation of perquisites one considered as under :-*

#### **a. Accommodation & Furniture**

Valuation of furnished and unfurnished accommodation is made according to Valuation Rules. If the employer owns the furnishings, then 10 per cent of the cost will be added to the value of accommodation.

#### **b. Transport**

Broadly, no perquisite value is taken in the hands of individual employees in case where :-

- common transport such as bus provided to all the employees; or
- the employer is in the transport business; or
- a car is provided only for official use or for the purpose of travel from residence to office.

In other cases, a reasonable cost of such transport facilities will be treated as taxable value of perquisites in respect of such facilities

In case a car owned by the employer is provided to an employee exclusively for his personal uses, the taxable amount will be determined by taking reasonable expenses incurred by the employer on the car maintenance and depreciation on the car as per income tax rules.

If such car is used both for private and official purposes, then a reasonable proportion of the perquisite value relatable to the personal use will be taken as the taxable value of the car perquisite in the hands of the employee.

#### **c. Domestic servant**

Salary of domestic servants of employer paid by the employer, perquisite value will be taken as per rules.

**d. Gas, water or electricity:**

i. *Taxable perquisite* of providing supply of gas, water, or electricity will be nil, if the employer himself is engaged in the business providing these facilities.

ii. If the employer is not in the business of supply of gas, water or electricity, then the amount spent by the employee in providing the facilities to the employee will be the taxable value of perquisites in the hands of the employee provided the entire facilities are for the personal use of the employees only. Any amount recovered from the employee will be reduced from the perquisite value.

iii. Where the connection for gas, electricity, water supply is in the name of employee and the bills are paid or reimbursed by the employer, it is an obligation of the employee, discharged by the employer. Such payment is taxable in case of all employees under Section 17(2)(iv)

**e. Educational facilities:**

i. Taxable perquisite value of education provided by an employer being a school, college or educational institution will be nil.

ii. If the employer is not a school, college or educational institution, but is engaged in some other business or profession, the value of school fees or colleges fees of the children of the employee paid by the employer will be the taxable value of perquisites in respect if such facility.

iii. If the children of the employee are allowed free education in an institute run by the employer where the employer is engaged in other activities, then the value of the perquisites is reasonable cost of education and deemed by the income tax officer in the hands of specified employees.

**f. Medical facilities**

(i) A sum of up to Rs 15000 paid by the employer to the employee by way of reimbursement of medical expenses of the employee and his family will be exempt perquisite in the hand of the employee. Any payment made in excess of Rs. 15000 will be taxable.

(ii) If the treatment is taken in a government approved hospital or recognized hospital, or in government hospital, no value will be taken as the perquisite value in respect of such medical treatment reimbursement.

(iii) If the medical treatment is done outside India, then up to the amount approved by the RBI for such treatment, no perquisite value will be added to the taxable income of the employee. If payments made by the employer to the employee in this connection exceed the amount approved by the RBI, then such

excess will be treated as taxable salary in the hands on of the employee.

(iv) If the employer himself is a medical institution, provision of medical facilities will not attract any tax in the hands of the employee.

In other words, if an employer's own institution provides transport, education or medical facilities, there will be no taxable perquisite value in the hands of the employee.

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## **8. PROFITS IN LIEU OF SALARY – S 17(3)**

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U/s 17 (3), profit in lieu of salaries includes:

### **1. Compensation for Termination of Employment or modification of Terms & Conditions**

The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or the modification of the terms and conditions relating thereto;

### **2. Payment from Employer from PF or Other Fund**

Any payment (other than any pension, gratuity, HRA, Retrenchment compensation, etc) due to or received by an assessee from an employer or a former employer or from a provident or other fund , to the extent to which it does not consist of contributions by the assessee or interest on such contributions.

### **3. Keyman Insurance Policy**

Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

### **4. Sums Received from Future or Former Employer**

Any amount due to or received, whether in lump sum or otherwise, by any assessee from any person -

- (A) before his joining any employment with that person or
- (B) after cessation of his employment with that person.

### **5. Payment of Employee's Obligation Employer**

Any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee;

### **6. Payments from Certain Funds :**

Any sum payable by the employer, whether directly or through a fund, other than a recognised provident fund or an approved superannuation fund or a Deposit-linked Insurance Fund established u/s 3G of the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 or u/s 6C of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 to effect

an assurance on the life of the assessee or to effect a contract for an annuity;

## **7. Treatment of Annual Accretion to Provident Fund;**

Provident Funds are established to provide for the retirement benefits of the employees. Under the scheme of funds both the employer and the employee make contribution to the funds and interest is accumulated therein till an employee is retired. The funds are of three types, Viz.:\_

- i. Statutory Provident Fund (PF) set up or established and administered by the Government.
- ii. Recognised Provident Fund (RPF) set up by others but recognised by the Commissioner of Income Tax
- iii. Unrecognised Provident Fund (UPF) set up by others but not recognised by the Commissioner of Income Tax due to non-compliance with the guidelines laid down for recognition.

Following is the summary of tax treatment of different funds :

- (a) Employer's Contribution to statutory PF, interest thereon and the amount paid on retirement of the employee, all three are exempt.
- (b) Employer's Contribution to statutory RPF is exempt upto 12% of Basic Salary and interest on PF is exempt upto 8.5% p.a. Excess contribution or interest will be taxable. The amount paid on retirement of the employee will be exempt subject rules.
- (c) Employer's Contribution to UPF and interest thereon is exempt from tax, but it will be taxable, when paid on retirement of the employee U/s 17(3).
- (d) Employer's Contribution to all the three funds is exempt at the time of contribution.
- (e) If the P.F. is deducted from the salary of the employee, salary will have to be grossed up in all the three cases.
- (f) Employees' Contribution when received back on retirement is exempt in all the three above mentioned cases.
- (g) Interest on Employees' Contribution from UPF will be treated as Income from Other Sources.

## **8. Transferred Balance: - Section 17**

When an unrecognised provident fund is subsequently recognised, the balance standing in the unrecognised provident fund are transferred to the Recognised Provident Fund is called transferred balances and deemed to be the salary income of that year as per section 17 (1). Such amount to the extent such balance comprises of employees' contribution in excess of 12% of basic salary and interest credited in excess of 8.5%p.a.

## 9. Salaries exempt u/s

Section 10 provides for exemption of salaries of certain classes of employee and certain types of allowance and perquisites. A broad list of such exemptions is given below.

### a. Exemption of salaries to foreigners and non-resident employees

1. Interest income of non-resident (persons of Indian origin) from notified securities, saving certificates/ NRE Account. Purchased in convertible foreign exchange—Sec 10(4).
2. Remuneration / salary of
  - (i) foreign diplomats -Sec 10(6).
  - (ii) a trainee of a foreign government-Sec 10(6)(xi),
  - (iii) a foreign national as an employee of foreign Enterprise I – Sec 10(6)(vi)
  - (iv) Non-Resident Employee of a Foreign Ship—Sec 10(6)(viii)
  - (v) Person from a foreign government under Co-operative Technical Assistance Programme/ projects- Sec. 10(8)
  - (vi) a consultant under Grant Agreement between the International Organisation and the Government of Foreign State- Sec .10(8A) :
  - (vii) non-resident, engaged by the agency for rendering technical services in India in connection with any technical assistance programme or project, provided in accordance with an approved agreement- Section 10 (8A)
  - (viii) an Individual who is assigned to duties in India in connection with any Technical Assistance Programme and Project in accordance with an Agreement entered into by the Central Government and the Agency - Sec .10(8A)
  - (ix) an individual who is assigned to duties in India in connection with any technical assistance programme and project from a consultant referred to S 10(8A), income- S. 10(8B)
3. Income other than salary, royalty or fees for technical services from Government or an Indian concern under an approved agreement and if their tax liability is paid by the employer the tax so paid is exempt from tax. - Sec 10(6B)
4. Income accruing or arising outside India by any family member of persons covered u/s 10 (8),(8A) or (8B) , in respect of which such member is required to pay any income tax or social security tax to the Government of that foreign state. —Sec 10(9)

5. Amount of tax actually paid by an employer, at his option, on non-monetary perquisites on behalf of an employee in the hands of the employee. Sec – 10(10CC).

**b. Other Exemptions to salaried employees**

All the important exemptions in respect of allowances granted to employees have been dealt in detail earlier in this lesson. A broad list of all such exemptions is as under :-

- (i) Value of any travel concession/ assistance-S.- 10(5),
- (ii) allowance paid by the government to a Indian citizen rendering service outside India -Sec10 (7)
- (iii) Death cum Retirement gratuity -Sec-10(10)
- (iv) Commuted pension10 (10A),
- (v) Leave encashment Sec 10 (10AA)
- (vi) Retrenchment compensation -Sec 10(10B)
- (vii) Voluntary Retirement Compensation of -Sec 10(10C)
- (viii) Value of tax-paid perquisite -10(10CC)
- (ix) leave travel allowance,
- (x) Payment from statutory PF -Sec10(11)
- (xi) Any payment from National Pension Trust or upto 40% on closure of such account -Sec 10(12A /12B)
- (xii) house rent allowance 10(13A),
- (xiii) Special allowances etc. 10(14).

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## **9. DEDUCTIONS FROM SALARIES- SECTION 16**

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From the aggregate of taxable amounts chargeable as taxable salary viz. salary, bonus , allowances and perquisites (called gross salary), income under the head "Salaries" shall be computed after making the following deductions u/s 16, namely:—

**a) Entertainment Allowance**

A deduction in respect of any entertainment allowance specifically received by a government employee, a sum equal to one-fifth of his basic salary or Rs. 5,000 whichever is less.

**b) Profession Tax:**

A deduction of any sum paid by the assessee on account of a tax on employment ( profession tax) leviable by or under any law by the state government.

Other than that, no further deductions are allowed under this head.

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## **10. ILLUSTRATIONS**

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1. R, a Chartered Accountant was appointed as Finance Manager with ABC Bank on 1/4/2009 in the Salary grade of Rs. 12000 – 500 – 20000 – 1000 – 30000.

He was entitled to Leave Travel Concession for proceeding on leave of Rs. 4000. His actual expenditure on this account amounted to Rs. 5000.

As the bank is situated at a place where home food is available, R was offered Tiffin Allowance Rs. 6000, His actual lunch expenses amounted to Rs.10,000.

Reimbursement of medical expenses for treatment of R and his family in private clinic was Rs. 50,000

The Bank has provided free unfurnished flat at Mumbai (rent paid by Bank: Rs.80,000). However, the perquisite value of that Flat was Rs. 30000.

The employer provided two watchmen (salary Rs. 2000 per month each).

Free use of Santro car for official use, car can be used for journey between office and residence.

Free refreshments provided at place of work (Rs. 100 per day for 200 days).

*Compute Salary Income for the assessment 2018-19*

**Solution:**

**Computation of Salary Income R for AY 2018-19**

Particulars	Rs.
Basic salary (Rs 12,000 + 8 increments of Rs 500)	1,92,000
Leave Travel Concession (Exempt)	NIL
Tiffin Allowance ( Taxable)	6,000
Medical Expenses Reimbursed (50000 – 15000)	35,000
Rent Free Accommodation (Given)	30,000
Watchmen's Salary (2000 * 2 *12)	48,000
Santro Car only for Office use	NIL
Free Refreshments at workplace	NIL
Taxable salary	<u>3,11,000</u>

2. X is in negotiation with two employer A &B, who have made the following offers to X. Help him in making an appropriate choice.

Particulars	Rupees	
	A	B
Basic Salary	500000	50,0000
HRA – Actual Rent Rs. 200000	25,0000	0
Free House –fair rental value 50000	0	250000
Transport Allowance	100000	0

Free Use of Car – Amount spent		100000
Education Allowance for one child	5,0000	0
Free Education for 1 child. Amount spent	0	50000
Gardener Allowance	60000	0
Gardener's salary paid by employer		60000
Salary	<b>960000</b>	<b>960000</b>

**Solution****Taxable salary from employer A**

Basic Salary		500000
HRA (Actual)	250000	
Less : Exempt (HRA or 50 per cent of salary or Rent paid less 10 per cent of salary 200000- 10% of 500000)	<u>150000</u>	100000
Education Allowance	50000	
Less : Exempt (100*12)	<u>1200</u>	48800
Gardener Allowance		60000
Transport Allowance	100000	
Less : Exempt (800*12)	<u>9600</u>	90400
Taxable Salary		<b><u>799200</u></b>

**Taxable salary from employer B**

Basic Salary	500000
Free House Value	50000
Free Education for 1 child	50000
Gardener's Salary(120 * 12)	1440
Free Car	100000
<b>Taxable Salary</b>	<b>851440</b>

Taxable salary will be less with B, He should be preferred to A .

3. XY Ltd offers a job with following options to P, who is neither a director nor he has substantial interest in the company:

PARTICULARS	I	II
	Rs.	Rs.
Basic Salary	2,70,000	2,70,000
Bonus	10,000	10,000
Education Allowance for 2 children	10,200	--
Education facility for 2 children in an Institution maintained by the employer	--	10,200



Sweeper Allowance	10,000	--
Free Sweeper	--	10,000
Entertainment Allowance	6,000	--
Club Facility	--	6,000
Conveyance Allowance for personal use	12,000	--
Free Car Facility for Personal Use	--	12,000
Medical Allowance	18,000	--
Medical Facility for M and Family Members in own hospital	--	18,000
Free gas, electricity and water supply	--	4,500
Fair Rent Rent-free unfurnished house:	24,000	24,000

Which option M must choose on the assumption that he and XY LTD will both contribute 10% of salary towards unrecognised PF?

### SOLUTION:

PARTICULARS	I	II
	Rs.	Rs.
Income from Salary		
Basic Salary	2,70,000	2,70,000
Bonus	10,000	10,000
Education Allowance (10,200 - 2,400)	7,800	Exempt
Education Facility	--	Exempt
Sweeper Allowance/Facility	10,000	--
Entertainment Allowance/Club Facility	6,000	6,000
Conveyance Allowance/Car Facility	12,000	Exempt
Medical Allowance/facility	18,000	--
Allowance for gas/electricity/water/free facility	4,500	--
Rent free unfurnished house	13,430	7,600
Gross Salary	<b>3,51,730</b>	<b>2,93,600</b>

Taxable income is lower in option II, it should be preferred.

## 11. SELF ASSESSMENT QUESTIONS

1. What is Salary?
2. Discuss the difference profits in lieu of salary and perquisites.
3. Discuss various deductions available under the head salary.
4. Discuss the tax treatment of the perquisites for different employees.
5. Non- specified employees pay less tax than specified employees". Comment.

6. Rajesh is an employee of ABC Ltd. Since 1997, he is receiving entertainment allowance of Rs. 500 p.m. He submits following further information as on 31.03.2016 with the request to compute his taxable salary.

- a) Net Salary of Rs. 4,000 p.m. (including entertainment allowance of Rs. 500 p.m. but after deducting income tax Rs. 500, Provident Fund Rs. 500 and Profession tax Rs. 70)
- b) He is provided car for his exclusive use during office hours for office work. The petrol and other maintenance expenses come to Rs. 12,000 p.a.
- c) Receives Leave travel concession for himself and his family for proceeding on leave to hometown of Rs. 5,000 as prescribed, while actual amount spent by him was Rs. 3,500.
- d) During the year, he received free services of a cook. (Cost to the employer Rs. 4,400)
- e) Received Rs. 8,000 on encashment of leave to his credit.

7. R was an employee of R India Ltd since 1968 covered by the Payment of Gratuity Act, 1972, retired on 31 January 2018 after 35 years and 7 months' service. At the time of retirement her employer paid gratuity of Rs. 85,000 (exempt u/s 10(10) Rs. 50,000). R received Rs. 50,000 being the accumulated balance of recognised Provident Fund. The due date of salary etc was 1<sup>st</sup> day of the next month and were paid on due date. She was entitled to a monthly pension of Rs. 400 with effect from 1<sup>st</sup> day of February 2018, which becomes due on the last day of the month. Compute her taxable income for A.Y.2018-19

8. Compute the taxable income of H for the AY 2018-19 on the basis of the following further information:

- (A) Basic Salary Rs. 2,50,000 p.m.
- (B) House Rent Allowance Rs. 40,000 p.m. Taxable value is 50% of the amount received.
- (C) Project Allowance paid during the year Rs. 12,000.
- (D) Bonus paid during the year Rs. 3,600.
- (E) In retirement, on encashment of earned leave at his credit of 15 months he received Rs. 40,000 (Exempt u/s 10(10AA) Rs. 24,000)

9. S submits the following information pertaining to the year 31.3. 2018 and asks you to compute his income from salaries for the AY 2018-19.

- a) Basic Salary Rs. 25,000 p.m.
- b) Dearness Allowance Rs. 30,000 p.m.
- c) Bonus @ 20% on salary plus Dearness Allowance

- d) Employee contribution 12.5% of basic salary+ DA to RPF. Employer also contributes an equal sum.
  - e) Interest on balance credited to his RPF @ 14% p.a. Rs. 17,500
  - f) House Rent Allowance Rs. 1,50,000 p.a.
  - g) Profession tax paid by employee Rs. 840.
- He retired from services on 31.3.2018 opting for 60% commutation of pension and received Rs. 2,40,000 as the only terminal benefit. Rent paid Rs. 12,500 p.m.



## **INCOME FROM HOUSE PROPERTY (SECTIONS 22- 27)**

### **Synopsis:**

1. Introduction and objectives
2. Basis of Charge
3. Deemed owner
4. Income Exempt U/s 10
5. Computation of income from house property  
[GAV, NAV SOP, deemed let out partly let-out and partly self-occupied Co-ownership, deductions]
6. Miscellaneous- Arrears , Losses , TDs and no other deductions
7. Illustrations
8. Self - Examination Introduction and Objectives

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### **1. INTRODUCTION AND OBJECTIVES:**

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This lesson deals with the provisions of sections 22 to 27 relating to computation of income under the head “Income from house property”. Computation under this head is different because it covers actual as well as notional income, unlike other heads of income

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### **2. SCOPE AND BASIS OF CHARGE: S. 22**

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**1.1** Sections 22 to 27 deal with computation of income from house property in the following manner:-

- Section 22 defines the scope of income under this head.
- Section 23 gives the mode of computation of income.
- Section 24 specifies deduction available under this head.
- Section 25 deals with the amounts not deductible.
- Section 26 deals with property owned by co-owners.
- Section 27 gives the deeming provisions, where a person not being an owner of the property will be taxed as the deemed owner of such property.

**1.2** Under section 22, annual value of property consisting of any building or lands appurtenant thereto of which the assessee is the owner, shall be chargeable under the head income from house property.

As per the section property occupied for the purpose of assessee's own business or profession will not be chargeable under this head.

### 1.3 This head of income will be attracted -

- (a) In respect of income from a property being a building or land appurtenant or adjacent thereto. For this purpose :-
  - **'Building'** means any habitable four-wall structure covered by a roof. It is immaterial whether the building is residential or commercial such as warehouse, office or factory godown, wedding hall, auditorium, business centre, etc.
  - **'Land appurtenant'** means the land connected or adjacent to the building e.g. open space, approach roads, courtyard, compounds, courtyards, backyards, playgrounds, parking spaces, etc.
- (b) Income from any other property e.g. rental Income from a vacant plot of land is not chargeable to tax under this head unless it is appurtenant to a building.
- (c) The assessee must be the owner or deemed owner of house property during the previous year. Any subsequent change in the ownership of the property is immaterial.
- (d) Any person may be the owner whether an individual, HUF, firm, company, cooperative society or an association of persons.
- (e) A tenant is not the owner of a property. Hence, income of a tenant from sub-letting a rented property to another tenant is also not covered under this head. It will be taxable as business income or income from Other Sources.
- (f) The property is either let-out or used for own residence. The section specifically excludes a property used for assessee's own business or profession.

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## 3. DEEMED OWNER- SECTION 27

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Under section 27, following classes of persons shall be deemed to be the owner of a property although they may not be the legal owner thereof.

- a) An individual, who transfers any property to his spouse or a minor child, other than a married daughter, for inadequate consideration, shall be treated as deemed owner of that property although in such cases, legal owner of the property is the spouse or the minor child.
- b) The holder of an impartible estate is deemed to be the owner of the entire property. E.g., an HUF jointly holding a property on behalf of all its members shall be deemed to be the owner of such property although the property may be in the name of an individual member of family.

c) A member of co-operative society, company or other association of persons to whom a building has been allotted under a house building scheme of such society or company or AOP shall be deemed to be the owner of that property.

d) A purchaser, who has received possession of a property in part performance of a contract within the meaning of section 53A of the transfer of property Act, shall be deemed to be the owner of that property despite the fact that the agreement for buying of property has not been registered with the appropriate authority.

e) A lessee, who has acquired right by way of long-term lease of property for period of more than 12 years, shall be deemed to be the owner of such property. However, this provision is not applicable on any right by way of a lease renewable from month to month or for a period not exceeding one year.

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#### **4. HOUSE PROPERTY INCOME EXEMPT U/S 10**

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Section 10 to 13 provide for exemptions in respect of income from house property, to certain persons, institutions, organisations. Some of such exemptions are as under:-

- (a) A farmhouse used for agricultural purpose section- 10(1)
- (b) Income of one Palace of an ex- Ruler - section 10(19A)
- (c) A local authority section -10(20)
- (d) A scientific research association -section 10(20),
- (e) An Institution for development of Khadi & Village Industries -section 10(23BB)
- (f) Khadi & Village Industries Board -section 10(23BB)
- (g) A body for administration of charitable & religious trusts & endowments -section 10(23BBA)
- (h) Approved funds, educational institutions or hospitals - section 10(23C),
- (i) A trade union or association of trade union- section 10(24)
- (j) Resident of Ladakh district -section 10(26A)
- (k) Statutory corporations/ other institution or association finance by the government for promoting the interests of the members of the scheduled caste and scheduled tribes- section 10(26B)
- (l) Co-operative society for promoting the interests of the members of the scheduled caste and scheduled tribes- section 10(27)
- (m) A Property held for charitable purposes -section 11
- (n) A political party -Section 13

As per section 22, a property used for own business or profession, e.g. letting out property, or using it as , shop or

office or factory, guest house for business client, or for providing accommodation to, partners or directors or employees, will be excluded from the income from house property. Any income arising from such property will be chargeable income of the business or profession, not as income from house property.

Further as per section 23(1), one self-occupied property of an individual or a HUF assessee is exempt. This benefit is not available to a property which is let out nor to non-living entities like firms, companies, etc.

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## **5. COMPUTATION OF HOUSE PROPERTY INCOME:**

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Income from house property is computed by determining annual value of the house property as per section 23 and reducing therefrom the deductions available under section 24.

### **1.1. Annual Value -Section 23**

Section 23(1) does not give any definitive meaning to the term annual value. It only says that annual value means "the annual value determined under Section 23".

In common parlance, 'annual value' means the inherent capacity of a property to earn income or the amount for which the property may reasonably be expected to be let out from year to year.

Annual value does not refer to the rent of a property actually received but to the capacity or power of the property to fetch rent. Accordingly, a property need not necessarily be let out. Further, the annual value of a property depends on the use of the property- self occupied, let out or partly vacant and several other factors like its location, age etc.

### **1.2. Gross Annual Value [GAV]**

As per section 23(1)(a), annual value of a property is its-

- (i) Actual rent (AR), or
  - (ii) Reasonable lettable value (RLV);
- Whichever is higher?

(i) Actual rent [AR] means the rent received or receivable, where the property has been actually let out by the owner.

(ii) Reasonable lettable value [RLV] means the expected rent, which the property might reasonably be expected to yield from year to year. It is not necessary that a property must be let out.

Where a property is not let out, RLV may be estimated on the basis of the following factors:

- (a) **Fair rent** or the rent of similar properties in the same locality. The fair rent may be different in different circumstances or different contractual obligations.

- (b) **Municipal value (MV)** i.e. the ratable value of a property fixed by the local authorities for the purposes of assessment of local taxes payable. Municipal Value fixed according to prevalent market rent receivable in respect of a property, hence it is considered as a reliable criterion to determine the reasonable letting value of the property.
- (c) **Standard Rent i.e.** the rent fixed under the rent control laws to control or limit the rents prevailing in a locality. Law prohibits the landlord from charging rent in excess of the standard rent. There is no restriction to charge rent at a rate lower rent than the standard rent. Hence, actual rent can be more or less than the fair rent but can never exceed the standard rent.

### 1.3. Comparison of RLV and AR - Section 23(1(b)) :

As per section 23(1)(a), annual value of a property is higher of its actual rent (AR) vis-à-vis its reasonable lettable value (RLV). This may result in following two possibilities

- (a) AR is more than RLV, then AR will be GAV.
- (b) AR is less than RLV ( i.e. RLV is more than AR) and the reason for actual rent being less is because of -
  - I. Vacancy only and no other reason, then the AR ( even if it is lower) will be the GAV - u/s 23(1)(c)
  - II. any other reason, RLV shall be the GAV.

### 1.4. Other Important points:-

- (i) Actual rent will be relevant only in respect of let-out property. There cannot be any rent if the property remains vacant or is not let out at all or is a self-occupied property. In such cases, reasonable letting value will be sole guiding factor.
- (ii) The amount of rent actually received/ receivable during the previous year will be arrived after deducting rent for the period for which the property was vacant and unrealised rent or bad debts,
- (iii) In case of composite rent, expenses on providing amenities to the tenant such as water will be deducted to find out the actual rent.
- (iv) Actual rent shall not include the rent, which cannot be realised by the owner. However, the following conditions need to be satisfied for this:
  - (a) The tenancy is bona fide;
  - (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.

### Illustrations

1. A property is let out at a monthly rent of Rs. 11,000. Its Municipal ratable value is Rs. 10,000 per month, the fair rent is Rs. 14,000 per month and standard Rent is Rs. 12,000 p. m. The GAV will be computed as under :-

	Rs	Rs
I. Actual rent :Rs 11,000 p.m.		1,32,000
II. (a) Fair rent: Rs. 14,000 p.m.	1,68,000	
(b)Municipal value @ Rs.10,000 p.m	1,20,000	
Higher of the (a) and (b) – fair rent	1,68,000	
Standard Rent Rs 12,000 p.m.	1,44,000	
Fair rent cannot exceed the Standard Rent.		
Reasonable lettable value RLV restricted to:		1,44,000
Gross Annual Value (GAV) higher of AR/RLV		<b>1,44,000</b>

2. If the standard rent Rs. 18,000 p.m. , GAV will be as under :

	Rs	Rs
I . Actual rent: Rs 11,000 p.m.		1,32,000
II- (a) Fair rent – Rs. 14,000 p.m.	1,68,000	
(b)Municipal value: Rs. 10,000 p.m.	1,20,000	
Higher of the (a) and (b) – Fair Rent	<b>1,68,000</b>	
Standard Rent Rs 18,000 p.m.	2,16,000	
Reasonable Lettable Value <b>RLV</b>		1,68,000
Gross Annual Value Higher of the Two		<b>1,68,000</b>
<i>Standard rent being only a limiting factor is ignored.</i>		

3. If the actual rent Rs. 17,000 per month, the GAV will be : -

	Rs	Rs.
I. Actual Rent -Rs 17,000 per month		2,04,000
li. (a) Fair rent - Rs. 14,000 per month	1,68,000	
(b)Municipal value@ Rs .10,000 p.m.	1,20,000	
Higher of the (a) and (b) – Fair Rent	<b>1,68,000</b>	
Standard Rent Rs 12,000 per month	1,44,000	
RLV cannot exceed Standard Rent		1,44,000
Gross Annual Value <b>higher of AR/ RLV)</b>		<b>2,40,000</b>
Although charging rent over the standard rent an offence, yet for tax purposes legality of income is not relevant.		

4. A house is let out for Rs 15,000 per month for six months, and its RSV is Rs 3,60,000 . Here the AR is Rs 1,80,000 . There is a shortfall only because there was a vacancy of six months. Hence ,GAV will be Rs. 1,80,000

5. If a house is let out for @ Rs 5,000 per month and its fair rent is Rs 45,000 , Annual value will be the actual rent of Rs 60,000 because it is higher than the RLV Rs 45,000

6. If the RLV of a house is Rs 3,00,000 but the actual rent is Rs 20,000 per month, GAV will be Rs 3,00,000 (RLV) being higher than the actual rent of Rs. 2,40,000,

7. A house was let out on a monthly rent of Rs. 50,000 for 8 months only. Remaining 4 months it remained vacant. Reasonable lettable value of the house is Rs. 2,40,000. What would be its annual value?

**Solution:**

Actual rent is Rs. 50,000 p.m. for 8 months. The RLV is Rs. 6,00,000 for the full year. Actual rent Rs 4,00,000 is short by Rs 2,00,000 . The reason is solely on account of vacancy. The AR for full year would be Rs. 5,00,000, if there is no vacancy. The GAV will be Rs. 4,00,000 being the actual rent.

**1.5. Computation of net annual value:**

Section 23 classifies the house properties into different categories as discussed below:

**(i) Self-occupied business properties:**

Income from house property used for own business or profession is exempt from tax. If any rent or other income is generated from such property, the same should be treated as business income. Similarly, municipal taxes, repairs, insurance premium, and other expenses incurred on such property etc. will be admissible as business expenses.

**(ii) Self-occupied Residential Properties (SOP):**

Following are the provisions in respect of the annual value of a self- occupied residential property.

**A. Annual value to be taken as NIL**

Under Section 23 (2)(a) , annual value of a house or part of a house which is in the occupation of the owner( self-occupied property) for the purposes of his own residence shall be taken to be nil. Further, the exemption will also be available if the property cannot be actually occupied by the owner by because the owner resides at a different place in a building not belonging to him only because of his employment, business or profession carried on at any other place.

**B. Exceptions- Section 23(3)**

Exemption to a SOP will be denied in two cases, viz.:-

- a) If 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.

**C. More than one properties – Section 23(4)**

Where the self-occupied property consists of more than one house, then the exemption shall be available only in

respect of one of such houses, which the assessee may, at his option, specify in this behalf.

The annual value of the other house or houses shall be determined as such house or houses had been let out (Deemed to be let out property (DLP)).

In other words, where the assessee *owns more than one* self-occupied *properties*, the assessee, at his option, may *choose any one* property as self-occupied by him.

The remaining properties will be deemed or assumed to have been let-out (DLP) even if they are occupied by him and not actually let out. Annual Value DLP will be determined on the basis of the notional RLV based even if no rent has actually been received by the assessee. However, other deductions u/s 23 or 24 will be allowed in the normal manner.

#### **D. Exemption only to individuals and HUFs:**

Exemption for SOP is available only to *individuals and HUFs*. Other non- living persons cannot avail this exemption.

#### **E. No Deductions allowed from SOP except Interest:**

Where the annual value of a SOP is taken as nil, no deduction will be allowed from such annual value u/s 23 or 24 except in respect of interest paid or payable on borrowed funds. In other words, municipal taxes will not be allowed as deduction while computing, nor repair allowance of 30% of annual value will be allowed u/s 24.

#### **F. Deduction of interest : -**

##### **(i) Amount deductible**

Interest payable on funds borrowed for acquisition , construction repair, renovation or reconstruction will be allowed subject to following limits:-

- a) Fund borrowed prior to 01-04-1999 to acquire, construct, renew or restructure the property – Rs 30,000.
- b) Fund borrowed on and after 01-04-1999-
  - Rs 30,000 if the funds are borrowed for repairs of the property , and
  - Rs 2,00,000 if the funds are borrowed to acquire or construct the property and such acquisition or construction of the property is completed within 3 years from the end of the financial year in which capital was borrowed,

##### **(ii) Pre-construction interest**

Interest payable on capital borrowed to acquire or construct the house property, for the period prior to the previous year in which the property has been acquired or constructed, will be allowed as deduction in five equal instalments beginning from that previous year and for each of the four immediately succeeding previous years:

**(iii) Interest allowed under other provisions :**

Amount of interest will be reduced to the extent it is allowed under any other provision of the Act.

**(iv) Interest on new loan to pay old loan :**

Where the assessee, subsequent to the capital borrowed for construction or acquisition etc. of property takes a new loan to make repayment of old loan, interest payable on such new loan will also be allowed. However, any interest payable on interest will not be allowed as deception.

**(v) Accrual basis**

Interest on capital borrowed is allowed as deduction when it is accrued. Actual payment during the previous year is not necessary.

**(vi) Other provisions:**

- I. Brokerage or commission paid to arrange a loan for house construction is not allowed as deduction.
- II. Interest payable on loan taken for construction etc. of a property is allowed and not on any loan taken for payment of interest.
- III. Any loss arising under the head "income from house property" may be set-off against the other heads in the same assessment year for a period of 8 years from the year of loss.
- IV. The assessee is required to furnish a certificate, from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property, or, conversion of the whole or any part of the capital borrowed which remains to be repaid as a new loan.

**Illustrations**

1. A borrows Rs. 15 lakh @ 10% p.a. to construct a house for own residence on 01-06-2014. The construction was completed in May 2017.

The construction is completed within three years of taking the loan, Rs. 1,20,000 will be allowed being the interest for F.Y. 2017-18. Interest paid in F.Y. 2014-15, 2015-16 and 2016-17 Rs. 3,40,000 will be allowable in five equal instalments of Rs. 68,000 for five years beginning from A.Y. 2018-19 subject to a limit of Rs. 2,00,000.

2. Assuming the loan was taken in 1998, the deduction would be restricted to Rs. 30,000.

3. If the loan was used for repairs of the bungalow, the deduction would be restricted to Rs. 30,000.

4. If the construction of the house could not be completed till December 2017 i.e. within three years of taking loan, the deduction will be restricted to Rs 30,000.

### **(iii) Let-out Properties (LOP)**

Following principles will be applicable for determination of annual value of properties let out including deemed to be let out. (Self-occupied properties (DLOP))

#### **1. Net Annual Value (NAV)**

Net annual value of a let-out property value (NAV) is arrived at by deducting Municipal taxes *paid* by the owner from GAV- Proviso to Section 23(1) :

$$\text{NAV} = \text{GAV} - \text{Municipal Taxes paid by the owner.}$$

Municipal taxes will be deducted on payment basis, not accrual basis. Further Municipal taxes paid or borne by the tenant are not deductible

#### **2. Deductions under section 24:**

##### **a) Standard deduction**

Standard deduction to the extent of 30% of the net annual value is allowed in respect of repairs and collection charges is allowed, irrespective of whether the assessee has actually incurred the expenses or not. However, this deduction will not be allowed in the hands of the owner of the property, if the repairs are borne by the tenant,

##### **(b) Interest on funds borrowed**

Interest on loan taken for acquisition, construction, renewal, repairs or reconstruction is allowed on let-out properties without limit of Rs 30,000/ 2,00,000 unlike in case of a SOP. The interest on loans is allowable on accrual basis. Similarly, pre-construction interest from the date of the loan to the end of the previous year before the previous year in which the house was acquired is amortized 1/5th per year for 5 years as in case of SOP from the financial year in which the construction was completed. .

#### **Illustration**

On 01-10-2011 A borrowed Rs. 10,00,000 @ 12% p.a for the construction of his house. The house was finally constructed on 31-03- 2014 and let out.

In this case loan is taken on 01-10-2011 and the house is the house constructed in F.Y. 2013-14(A.Y. 2014-15) (within three years). Interest for preconstruction period 01-10-2011 to 31-03-2014 Rs 3,00,000 will be amortized in five equal instalments of Rs 60,000 each from A.Y 2013-14 till 2018-19.

**(iv) Property let-out and self-occupied for part of the year**

A property is let-out for whole or any part of the year and self-occupied for the remaining part of the year, shall be treated as let-out property and computation will be made accordingly by comparing actual rent with the fair rent for the whole property u/s 23(1). It will not be treated as SOP as Section 23(3) makes it clear the SOP shall not be let-out for any part of the year nor should any benefit be derived from it.

**(v) Property partly let-out and partly self-occupied:**

If a part of the property – say one or two floors or few rooms have been let out and another part of the property is self-occupied, then for each portion the calculation will be made separately. Relevant expenses like property taxes and interest will be allocated suitably for each portion and deductions will be allowed separately for each portion.

Note the difference between properties let out /SOP for split period and with split portion used for letting out/SOP.

**(vi) Co-ownership – Section 26:**

A property owned by more than one owners having definite and ascertainable share therein, will not be assessed as an association of persons but share of each owner shall be included in his individual income. If co-owners themselves occupy the property, share of each owner will be treated as nil. Each of the co-owners would be entitled to the deduction in respect of interest subject to the limit of Rs 30,000 or Rs 1,50,000, as the case may be.

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**6. MISCELLANEOUS:**


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**A. Recovery or realization of past arrears/ unrealised rent.**

As per the section 25A, which has been introduced in place of the old sections 25A, 25AA and 25B, arrears of rent/ or any unrealised rent will be taxable in the year when it is realised or recovered regardless of whether the assessee does or does not own the property in the that year and 30% deduction is allowable in that year.

**B. TDS**

Interest paid to a non-resident outside India without deduction of tax at source will not be allowed as deduction.

**C. Set off and carry forward of losses :**

Any loss arising under the head “Income from House Property” in respect of interest only can be set off against income arising from other heads and the remaining loss will be allowed to be set off and carried forward for a period of 8 assessment years.

**D. No other Deductions allowed;**

No deduction would be available in respect of charges like electricity, land revenue, ground rent, insurance, etc. even though they may be actual outgoings since the standard deduction of 30% is supposed to take care of all expenses.

**7. ILLUSTRATIONS:**

1. Find out the Gross Annual Value in the following cases:-

Particulars	Property				
	I	II	III	IV	V
Municipal Value	8000	8000	8000	8000	8000
Rent Received	8200	8200	8700	8700	9000
Fair Rental Value	8600	8600	8600	8800	9100
Standard Rent under [Rent Control Act]	NA	8500	8500	8500	10300

Solution:					
	I	II	III	IV	V
Municipal Value	8000	8000	8000	8000	8000
Rent Received	8200	8200	<b>8700</b>	8700	9000
Fair Rental Value	<b>8600</b>	<b>8600</b>	8600	<b>8800</b>	<b>9100</b>
Standard Rent under Rent Act	NA	<b>8500</b>	8500	<b>8500</b>	10300
Gross Annual Value	8600	8500#	8700@	8500#	9100\$

# Fair rent limited to Standard Rent Rs. 8,500

@ Actual rent even if it's more than standard rent.

\$ Standard rent is only a limiting factor, hence ignored.

2. A owns two houses, A & B. A is let-out throughout the previous year. And B is self-occupied for nine months and let-out for three months on a monthly rent of Rs 5,000. Determine Taxable income, given the following details:-

	House A	House B
Municipal Value	30,000	60,000
Fair Rent	40,000	50,000
Rent Received	48,000	15,000
Municipal Taxes paid	6,000	4,000
Insurance Premium (not yet paid)	2,000	2,500
Ground Rent	1,000	1,500
Maintenance Charges	3,000	3,500
Electricity Bill	5,000	6,000

**Solution:**

	House A	House B
Gross Annual Value (Actual rent fair re for A and municipal value for B)	48,000	60,000
Less : Municipal Taxes paid	6,000	4,000
Net Annual Value	44,000	56,000
Less : Deduction u/s 24		
Repairs & Collection Charges 30%	13,200	22,400
Taxable Income	30,800	33,600

**8. SELF EXAMINATION QUESTIONS:**

1. What is annual value? How is it determined?
2. Discuss briefly the various expenses and allowances that are deductible under the head "Income from House Property"
3. Mention the amounts which are not deductible from Income from House Property
4. Write a short note on property owned by co-owners
5. Explain briefly (a) Owner of a house property (b) A member of a co-operative society (c) Annual Value
6. What do you mean by "Self-Occupied house property"? How is the annual value of such property determined?
7. Explain briefly, house property "deemed to be let-out" and how the income from such house property is determined?
8. Is interest paid on a housing loan out of India allowable as a deduction?
9. Explain with reason if the Interest paid by the assessee on borrowed capital in the construction of the property, till the date of letting out an admissible expenditure.
10. Discuss the provisions of Income Tax Act regarding unoccupied residential house?
11. Enumerate and explain if any, the exceptions to the rule that Ownership is the criterion for assessment of Income from house property under Section 22"
12. Discuss tax liability of arrears of rent.
13. Explain the provisions of the Income Tax Act with respect to the computation of income from a self-occupied house property.
14. Explain the tax treatment of unrealized rent.
15. Lakdawala completed construction of a residential house on 1.4.1999. Interest paid on loans borrowed for construction during the 2 year prior to completion was Rs



20,000/- and for the current years was Rs 10,000 The house was let out on a monthly rent of Rs. 4,000/-. Annual Municipal tax was Rs. 6,000/-. Interest paid during the year is Rs. 15,000/-. Amount spent on repairs is Rs. 2,000/-. Fire insurance premium paid is Rs. 1,500/- p.a. The property was vacant for 3 months. Annual letting value is Rs. 30,000/-. Compute the "Income from House Property" for AY 2018-19 (Ans. Rs. 8,500)

16. Ram owned a house property at Chennai which was occupied by him for the purpose of his residence. He was transferred to Mumbai in June 2017 and therefore he let-out the property with effect from July 1, 2017 on a monthly rent of Rs. 3,000/-. The municipal tax payable in respect of the property was Rs. 6,000/- of which only 50% was paid by him before 31.3.2018. Interest on money borrowed for the construction of the property amounted to Rs. 20,000/- Compute the income from house property for the AY 2012-13( Ans. Loss Rs 8250 )
17. Arvind commenced his construction of a residential house intended exclusively for his residence on 1.11.2012. He raised a loan of Rs. 5,00,000/- at 10% interest for the purpose of construction on 1.11.2006. Finding that there was an overrun in the cost of construction he raised a further loan of Rs.8 lakh at the same rate of interest on 1.10.2014. What is the interest allowable under Section 24 assuming that the construction was completed on 31.3.2016?

(Ans. Loss Rs. 1,50,000 pre- construction interest 1/5th)

18. From the following particulars of his property furnished by S, compute income from house property. S owns a residential house actually let out for 10 months for total rent of Rs. 25,000. Fair rent of this house is Rs. 27,000 and municipal ratable valuation is Rs. 24,000. Total outgo on account of this house included repairs of Rs. 9,000, Municipal taxes of 18 months Rs. 9,000 and insurance premium of Rs. 1,500. Interest on funds borrowed amounted to Rs. 1,75,000.

He also owns another residential house at Andheri, which is used for own residence. Fair rent of this house is Rs. 80,000 and municipal ratable valuation is Rs. 75,000. Total outgo on account of this house included repairs of Rs. 6,000, Municipal taxes Rs. 18,000 and insurance premium of Rs. 1,500. Construction of this house was complete in 2016 from the funds borrowed from HDFC. During the current year, interest amounting to Rs. 90,000 was paid for the current year and Rs. 60,000 for the last year. A further interest of Rs. 65,000 was paid on loans taken for renovation necessitated due to heavy rains. The interest pertains equally to this year as well as the last year. ((Ans: L.O.P - loss 1,63,000 , SOP 1,50,000 –interest paid )

19. State with reason whether the following incomes will be taxable as income from house property.
- a) R lets out his house to Y for using it as his office.
  - b) R uses his house as the godown to store his factory goods .
  - c) R rents out his property as residential quarters to the workers in his factory at a nominal rent of Rs.500 p.m.
  - d) R enters into a written agreement to purchase a property from Y for Rs. 5,00,000 . He has paid the consideration and taken the possession of the property, but the property is yet to be registered in the name of R.
  - e) R owns a property, which is given on lease to Y for a period of 6 years, lease rent being Rs.10,000 per month. Y has a right to get the lease renewed for a further period of 6 years.
  - f) R owns a property, which is given on lease to Y for a period of one month, Y has a right to get the lease renewed for a period of one month, in each subsequent month, and such renewal is possible with mutual consent till 2020.
  - g) R owns a property, which is given on rent to Y. Y annually pays Rs.1,50,000 as rent of the building as well as the charges for different services ;lift, security, etc. provided by R.
  - h) R owns an air-conditioned furnished lecture hall. It is let out, annual rent being Rs 5, 00,000, which includes rent of building as well as rent of air conditioner and furniture.

(Ans : a, d, e, f, and g]



## **PROFITS AND GAINS OF BUSINESS OR PROFESSION (Sections 28 to 44)**

### **SYNOPSIS:**

1. Introduction and objective
2. Concept of business & Profession
3. Scheme of computation
4. Deductions expressly allowed under the Act
5. General deductions
6. Specific disallowances
7. Chargeability of profits
8. Miscellaneous provisions
9. Presumptive income
10. Typical Illustrations
11. Self-Assessment Questions

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### **1. INTRODUCTION AND OBJECTIVE**

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The lesson covers various aspects of the income from the head “Profits and gains of business and profession”, its computation, general and specific deductions allowable under this head and also items not allowed as deduction to the extent contained in Sections 28 to 32, 35, 36, 37, 40, 40A, 43B.

The income under the head “profits and gains of business and profession” includes “profits” and “gains” of “Business” and “Profession” including their different types and forms viz. vocation, trade, commerce, manufacture and any adventure in the nature of trade or profession.

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### **2. CONCEPT OF BUSINESS AND PROFESSION :**

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#### **2.1 Definitions**

##### **2.1.1. Business :**

Sec. 2 (13) defines Business as under -

*“Business includes any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce or manufacture.”*

The definition of “business” is an inclusive one. It includes “business” in its general commercial sense but also several other activities, namely- trade, commerce, manufacture and any adventure in the nature of trade, commerce or manufacture.

Business, trade and commerce refer to buying and selling of goods or services for profit and other incidental activities. Manufacturing means producing new goods or articles.

### 2.1.2. Profession

Section 2(36) gives an inclusive definition of “profession” viz. **“Profession” includes vocation**”.

“Profession” in common parlance means rendering of skilled services like as those of doctors, architects, lawyers, chartered accountants or other professionals.

Vocations mean a specified occupation, profession or trade or calling or career especially a religious one. It will, therefore include services of priests, preachers delivering sermons or discourses, management gurus, yoga gurus, palmists and astrologers, tarot readers, plumbers, mechanics, priests performing havan or pooja etc.

### 2.1.3. Adventure

The phrase “Adventure in the nature of trade, commerce or manufacture” indicates that business or profession need not be organised, systematic or regular. A single act may constitute a business or profession. For instance, when a land was purchased developed and subdivided in smaller plots for resale was held as an adventure in the nature of trade or commerce or manufacture.

### 2.1.4. Provisions to apply uniformly

Income under this head will be uniformly chargeable to tax regardless of the following considerations:-

- a) **Type or description** of an activity namely a business, a profession, or an adventure in the nature of business or profession. However, there are some provisions dealing with some specific cases such as presumptive tax applicable to different activities.
- b) **Legality or illegality** of the activity. Accordingly, income from theft, bribery or smuggling or other criminal or illegal activities will be chargeable to tax under this head just like the income of a legal and legitimate business or profession.
- c) **Regularity or irregularity** of the business or profession. A business or a profession may be regular, irregular or occasional. Even the activity of a single activity or adventure will be chargeable under this head if it is in the nature of a business or a profession :-
- d) **Organised or unorganised** ; and
- e) Whether or not requires **personal talents or skill**.

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### 3. SCHEME OF COMPUTATION -SECTION 28-29

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#### 3.1. Chargeable income- (Section 28) :

Under Sec 28 following income are chargeable to income-tax under the head "Profits and gains of business or profession"—

- (i) the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year;

#### *Compensation for termination or modification of contracts*

- (ii) any compensation or other payment due to or received by any person at or in connection with the termination of contract modification of the terms and conditions relating thereto for ;

- a. managing the whole or substantially the whole of the affairs of an Indian company,
- b. managing the whole or substantially the whole of the affairs in India of any other company,
- c. holding an agency in India for any part of the activities relating to the business of any other person by any person,
- d. vesting in the Government, or in any corporation owned or controlled by the Government, under any law ,of the management of any property or business ;

- (iii) income derived by a trade, professional or similar association from specific services performed for its members;

#### **Export incentives**

- (iiia) profits on sale of an import licence ;
- (iiib) cash assistance received or receivable by any person against exports under any scheme of the Government of India ;
- (iiic) duty drawback in respect of customs or excise duty person against exports ;
- (iiid) any profit on the transfer of the Duty Entitlement Pass Book Scheme (DEPB);
- (iiie) any profit on the transfer of the Duty Free Replenishment Certificate;
- (iv) value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;
- (v) any interest, salary, bonus, commission or remuneration due to or received by a partner of a firm as adjusted by any amount not allowed to be deducted u/s 40(b);

#### **Non- compete agreement**

- (va) any sum, whether received or receivable, in cash or kind, under an agreement for not carrying out any activity in relation to any business or profession or not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or

commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services if such amount is -

- chargeable under the head "Capital gains" or
- Received as compensation, from the multi-lateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme (UNEP), in accordance with the terms of agreement entered into with the Government of India.

(vi) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy;

(vii) any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD (scientific research) in earlier years;

(viii) Amount recovered on account of bad debts allowed in the earlier years;

(ix) Speculation Business

Speculation business is deemed to be distinct and separate from any other business if speculative transactions; which are settled by payment of difference in price of goods or securities and not by actual delivery; carried on by an assessee are of such a nature as to constitute a business.

### **3.2. Computation of business income –Section-29:**

1. Section 28 is the charging section, which defines the scope of income under the head profits and gains of business or profession being the aggregate of all income from different sources specified in the section in respect of a business or profession carried on by the assessee. any time during the previous year ;
2. Section 29 gives the mode of computation of taxable income under this head viz. by deducting from the aggregate income, expenses incurred by the assessee during the previous year for earning such income.
3. The deduction of expenses incurred is subject to the following principles or conditions:-
  - a. Expenses will not be deducted, if the business or profession is closed down during the previous year.
  - b. Expenses incurred before setting of the business will not be allowed except where specifically provided by law.

- c. Some expenses are fully deductible, while others are deductible only partially ;
- d. Similarly, some deductions are assessee -specific i.e. allowable to some classes of assessee e.g. a company or a firm but not to others ;
- e. Some deductions are without conditions, while others are subject to fulfillment of conditions attached with the deduction.
- f. The expenses may be deducted in accordance with the conditions attached in section 28- 43D, viz.
  - i. Sections 30 to 35 provide expressly for deduction of expenses in some cases.
  - ii. Sections 36 and 37 provide for general deductions.
  - iii. Sections 40, 40A and 43B provide for disallowance of expenses in certain circumstances; which are otherwise deductible.
  - iv. Sections 44A to 44D deal with the computation of income on presumptive basis in case of smaller assessee like professionals, retailers, insurance agents, transporters etc.

### **3.3. Method of Accounting: (Sec 145 / 145A)**

As per section 145(1), income chargeable under the head “Profits gains of business or profession “or” income from other sources may be computed according to either cash or mercantile system of accounting regularly employed by the assessee.

#### **a) Mercantile system or accrual system of accounting**

Under the mercantile or accrual system of accounting, income and expenditure accrued during the previous year will be recorded in the books and the taxable income from profits or gains from such a business or profession will be the difference between the expenses or income accrued during that previous year.

Actual receipt of the income or payment of expenses during the year is not mandatory. Instead, such income may be received, or expenses may be paid in the previous year or in a year preceding or following the previous year.

#### **b) Cash system of accounting**

Under the cash system of accounting, incomes actually received, and expenses actually paid during a particular previous year will be recorded and considered for computing taxable profits

or gains from a business or a profession. Net profit under the cash system will be equal to the difference of incomes received and expenses paid during the accounting year whether such receipts and payments relate to that particular year or some other year or years.

### c) Hybrid system of accounting

When accounts are maintained as per the accrual or mercantile system, but some items of income or expenses on cash or receipt basis, it is called hybrid system of accounting, because it combines the features of both the methods. Even statutorily, section 43B provides for deduction of specified statutory dues only when they are actually paid although the method of accounting employed may be mercantile.

### Illustration

A earns commission in the financial year 2017-18 but receives it in the year 2018-19. Under the mercantile system, the commission will be taxed in the year of earning it viz 2017-18 or A.Y. 2018-19, although not actually received during that year.

Under the cash system, it would be taxed in the year of actual receipt P.Y. 2018-19 (A. Y. 2019-20), although not earned in that year.

### d) Income Computation & Disclosure Standards

As per Section 145(2), the Central Government may notify in the official gazette from time to time Accounting Standards to be followed by any class of assessee or in respect of any class of income. Such accounting standards are called Income Computation and Disclosure Standards (ICDS). So far, the CBDT has notified 10 Income Computation and Disclosure Standards (ICDS), effective from A.Y. 2017-18 onwards.

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## 4. DEDUCTIONS EXPRESSLY ALLOWED

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The following expenses are expressly allowed as deductions against profits and gains of business or profession:

### 4.1 Rent, Rates, Taxes, Repairs & Insurance for Building- Section 30

Vide section 30, rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession are deductible as under:-

- a) The amount paid as **rent** or on account of **repairs** in respect of the premises occupied by the assessee as tenant.
- b) the amount paid on account of current repairs to the premises occupied by the assessee otherwise than as a tenant,



- c) any sums paid on account of land revenue, local rates or municipal taxes subject to the provisions of section 43B ; and
- d) the amount of insurance premium paid against risk of damage or destruction of the premises .

The deduction is subject to the following modifications:-

- (i) Capital expenses are not allowed as deduction under this section.
- (ii) Where a part of any premises is partly used as dwelling house by the assessee, the deduction will be restricted to proportionate amount of rent or repairs determined by the assessing office applicable the part of the premises used for business/ profession- section 38.

#### **4.2 Repairs & Insurance of Machinery, Plant & Furniture- Section 31:**

Under Sec. 31, the following deductions are allowed in respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession:—

- (i) the amount paid on account of current repairs thereto if such expenses are revenue expense, not capital expenses;
- (ii) the amount of any insurance premium paid against risk of damage or destruction thereof.

In a case, where the building, machinery, plant or furniture is not exclusively used for the purposes of the business or profession, the deduction shall be restricted to a fair proportionate part thereof which the assessing officer may determine, having regard to the user of such building, machinery, plant or furniture for the purposes of the business or profession.

Machinery hire charges are allowed not u/s 31 but u/s 37 as residual expenses.

#### **4.3. Depreciation - Section-32:**

##### **4.3.1 Conditions for claiming depreciation:**

U/s 32 an assessee is entitled to claim deduction in respect of depreciation in computing the total income if he fulfills the following conditions:-

##### **(i) Claim not necessary**

Depreciation will be allowed as deduction irrespective of whether or not the assessee has made a claim for deduction so long as the conditions for the allowance of depreciation are satisfied.

**(ii) Depreciation allowed on eligible assets only:**

Depreciation will be allowed only on the following assets called depreciable assets:

- a) *Tangible assets*; being  
Buildings, machinery, plant or furniture.
- b) *Intangible assets* being  
Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

**“Building”** means only the superstructure, not the land on which it is constructed.

**“Plant”** includes ships; vehicle, books including technical know-how; scientific apparatus and surgical equipment used for the purpose of business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.

**(iii) Assets not eligible for depreciation**

Following assets are not eligible for depreciation:

- a) Foreign car - acquired between 01/03/ 1975 and 31/03/ 2001 (only academic as *foreign cars purchased on or after 01/04/2001 will be eligible for depreciation*) ; and
- b) Any machinery or plant if the actual cost thereof is allowed as a deduction in one or more years under an agreement entered into by the Central Government under section 42.

**(iv) Ownership – Partial ownership:**

Assessee must own the depreciable asset wholly or partly as the sole owner or the co-owner thereof. In case of an asset owned by different assesseees, each co-owner will be entitled to depreciation on his contribution to the cost of asset.

**Exception:**

Depreciation will be allowed on capital work or renovation or construction of any structure in building though *not owned* by the assessee, which is held on lease or other right of occupancy and the new structure is owned by the assessee

**(v) Purpose or user of the assets**

The assessee must use the asset for the purpose of his business or profession.

**(vi) User of the assets during the previous year:**

If an asset acquired by the assessee during the previous year, is put to use for the purposes of his business or profession for

a period of 180 days or more, then, the depreciation will be allowed at full rate prescribed.

If the asset is put to use during the previous year for a period of less than 180 days; i.e. 179 days or less; depreciation will be allowed @ 50% of the rate prescribed.

The condition is applicable on an *asset acquired during the year*; no other asset. This is because the machinery would undergo wear and tear even if it was not put to actual use.

### **Illustration**

A Machine is purchased on 31/03/2017, but it is put to use on 01/04/ 2017.

No depreciation will be allowed depreciation in A.Y. 2017-18 because the machine, though acquired, is not put to use during the previous year 2016-17. Full depreciation will be allowable A.Y. 2018-19

### **4.3.2 Additional Depreciation- Section 32(1)(ia)**

U/s 32(1) (ia), (read with Sec 32AD) provides for allowing additional depreciation over and above the *normal depreciation as per the following scheme:-*

#### **(i) Eligible Assessee**

Any assessee being an *industrial undertaking* engaged in the business of *manufacture or production of any article or thing, or transmission of power*.

#### **(ii) Rate of additional depreciation allowable**

a) 20% of the actual cost of new plant or machinery (not being ships or aircrafts) acquired and installed after 31st March, 2005.

b) 35% of the actual cost *in case of the assessee being a manufacturing undertaking or enterprise set up in the notified backward areas of the States of Andhra Pradesh, Bihar, Telangana and West Bengal on or after 1st April, 2015 and the Assessee acquires and installs new plant & machinery between 01-04 2015 & 31-03-2020.*

c) 50% of the above rates i.e. 10% or 17.5%, where the plant or machinery is acquired and installed for less than 180 days of the relevant previous year and the balance 50% will be allowed in the immediately succeeding previous year.

(iii) **Assets not be eligible for additional depreciation: -**

- a. Ships and aircrafts;
- b. Second hand machinery used by any other person in or out of India;
- c. Machinery installed in a residential premises or a guesthouse;
- d. Any office appliances or road transport vehicles;
- e. Any plant or machinery, actual cost of which is already allowed as a deduction e.g. asset for scientific research; and
- f. Buildings, furniture & fittings and old plant

**4.3.3 Important Terms :**

**(i) Block of Assets**

As per Sec 2(11) – “*block of assets*” means a group of assets falling within a class of assets comprising of —

- a) Tangible assets, being buildings, machinery, plant or furniture;
- b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed.

As per the definition, block of assets is a classification of assets based on the twin criteria of:

- (a) Class of asset viz. building, plant, furniture or machinery to which the asset belongs to ; and
- (b) Rate applicable on the asset within that class.

The assets within a class eligible for same rate will form a block of assets but not assets from different groups having same rate nor the assets from different classes having same rate. A block may have a single asset in it.

**(ii) Written Down Value (WDV) of an asset**

Written down value of an asset means:

- a. actual cost to the assessee of the asset acquired in the previous year, and
- b. the actual cost to the assessee less all depreciation actually allowed thereafter.

**(iii) Written Down Value (WDV) of block of assets**

Written down value of any block of assets, means

**a. the opening WDV of the block of**

- the assessee or

- the previous owner or entity, in case of slump sale, amalgamation, succession of business, demerger, conversion into company etc. or holding /subsidiary company )

**b. adjusted by: -**

- (i) *the increase* by the actual cost of any asset falling within that block, acquired during the previous year; and
- (ii) *the reduction* of the moneys payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, so, however, that the amount of such reduction does not exceed the written down value as so increased.

**Other important points:**

- (i) Any other things or benefit which can be converted in terms of money cannot be deducted
- (ii) If the resultant block value figure is negative because the sale proceeds exceed the original block value plus increases, it will be treated as short term capital gain.

**Illustration**

Opening value of block having four machines (depreciation @ 15%) is Rs 7,00,000 as at 01/04/2017. On 01/06/2017. Purchased another machine with depreciation @ 25% for Rs 3,00,000. Sold an existing machine for Rs 6,00,000. Ascertain depreciation for the A.Y.2016-17 and the closing value of block as on 31-03-2018.

**Solution :**

	Rupees
WDV as on 1/4/2017	7,00,000
Add: Purchase during the year	3,00,000
	<u>10,00,000</u>
Less: Sales during the year	6,00,000
Adjusted Block	<u>4,00,000</u>
Depreciation @ 15 per cent	<u>60,000</u>
WDV of block as on 31 /3/2018	<u><u>3,40,000</u></u>

**(iii) Actual Cost**

Actual cost is determined on the following principles

*i. Subsidy or grant to be reduced to determine actual cost*

Actual cost means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority (subsidy or grant and expenses incurred for acquiring the asset or installation) - Sec.43(1). Grant /subsidy whether of revenue nature

or of capital nature are taxable as income, unless it has been reduced from the actual cost of a depreciable asset.

### Illustration

ABC purchases a machine for Rs 12 lakh with non-refundable subsidy of Rs. 3 lakh from the Government. Actual cost of the machine will be Rs. 9 lakh [Rs. 12 lakh-Rs 3 lakh].

### ii. Scientific Research Asset

Actual cost of asset purchased for scientific research and brought into business use will be *Actual Cost minus deduction available u/s 35*.

### Illustration

A purchases a machine for scientific research for Rs 12 lakh with the non-refundable subsidy of Rs. 5 lakh from SIDBI. The machine is eligible for deduction u/s 35 to the extent of Rs. 3 lakh. Actual cost of the machine will be Rs. 4 lakh i.e. Rs. 12 lakh- Rs 5 lakh - Rs. 3 lakh

### iii. Gift, inheritance etc.

Actual cost of asset acquired by way of *gift* or *inheritance* will be the WDV to the previous owner.

### Illustration

If A gifts away to B the machinery in the above illustration, the cost of machine to B will also be Rs. 4 lakh, which was the cost to A.

### iv. Enhanced cost

Where in the opinion of the assessing officer, an asset is acquired at an enhanced cost to claim more depreciation and reduce tax liability, actual cost will be equal to the actual cost of asset used and transferred earlier but now reacquired or cost of repurchase, whichever is less.

### Illustration

A sold a machinery with WDV of Rs 9 lakh for Rs. 10 lakh and repurchased it after two years at the prevailing market value of Rs. 20 lakh. If the assessing officer is of the opinion that the machine is repurchased for claiming more depreciation, he can ignore the enhanced purchase value of Rs. 20 lakh and treat Rs. 9 lakh as the actual cost.

### 4.3.4 Mode of computation

Following principles are important in computing the depreciation:

- Depreciation is calculated on the WDV of the block after adjusting the sales and purchase during the year in that block.

- Rates of depreciation for different assets are taken as prescribed in rules.
- Depreciation will not be allowed on a block if-
  - WDV of that block comes to zero, even if some assets in that block may be existing.
  - No assets are left in the block and the become empty, or ceases to exist. WDV of the block will be treated as short term loss.
- Depreciation will be allowed at 50% of the prescribed rate, if the asset is put to use for less than 180 days in the year of acquisition.
- Straight Line Method (SLM) method is applied in case of the assets of the power companies i.e. undertakings engaged in generation or generation and distribution of power at the prescribed rates of depreciation on the *actual cost* of the assets.
- Additional depreciation of 20% or 35% on actual cost in is allowable as discussed above.
- Different treatment is given to depreciation on foreign cars purchased between 1975- 2001 as depreciation has been denied to such cars subject to some exceptions discussed earlier.
- Depreciation will not be allowed on scientific research assets, entire cost of which is allowed as deduction u/s 35.

#### **4.3.5 Succession of Business**

Succession means takeover of a business by another new entity e.g.

- conversion of a firm or sole proprietor to company -section 47(xiii)/(xiv),
- succession of a private or unlisted public company, by limited liability partnership- section 47(xiiib), or
- Amalgamation / demerger/ succession of business - section 170.

In such cases, aggregate depreciation for a year will not exceed the amount of depreciation, had such event not taken place and such depreciation shall be apportioned between the old and new entity

#### **Illustration**

Under a scheme of amalgamation, A Ltd, transfers to B Ltd, machinery having WDV of Rs 7,30,000 on 1/08/2017. Calculate the depreciation in the hands of A Ltd. & B Ltd. If rate of depreciation is 10%.

**Solution:**

- Depreciation for the full year if the amalgamation has not taken place : Rs. 73000 [10% on Rs. 7,30,000 ]
- Aggregate depreciation for A.Y. 2018-19 cannot exceed Rs. 73000
- *Pro rata* allocation of depreciation for the two periods :

*Pre amalgamation* –  $122/365 \times 73000 = \underline{\text{Rs } 24,400}$

[01/04/2017 to 31/07/2017-= 122 days]

*Post amalgamation –  $243/365 \times 73000 = \underline{\text{Rs } 4,8600}$*

[01/09/2017 to 31/03/2018=243 days]

#### 4.3.6 Depreciation to be allowed even if no claim made

As per explanation 5 to section 32, the depreciation will be allowed whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income

#### 4.3.7 Loss on Sale of Machinery

When an asset is sold, discarded, demolished or destroyed in the previous year following rules apply:

- a) If block has not become empty and the *assets are still existing* in the block and also *some value is left* in the block, sales proceeds/ scrap value will be deducted from the value of the block and depreciation will be allowed on the resultant value of the block after **increase by the actual cost** of assets acquired, if any

## Illustration

One of the assets from a block with depreciation @ 25% having WDV of Rs. 6 Lakh is sold for Rs. 2 Lakh; the resultant value of the block will be Rs. 4 Lakh and the depreciation will be Rs. 1.00 Lakh

- b) When the *value of the block comes to zero, but assets still exist*, and the block has not become empty, depreciation will not be allowed.

## Illustration

A car in a block of four cars with opening WDV of Rs15 lakhs is sold for Rs. 15 Lakh. The value of the adjusted block will be zero. No depreciation will be allowed although three cars still exist in the block.

- c) If the sale proceeds are more than the adjusted WDV of the block, the resultant surplus will be treated as short term capital gain regardless of the fact that assets are still left in the block or the block is empty.



**Illustration**

In the above example, the car is sold for Rs 18 Lakh; the resultant surplus of Rs 3 lakh will be taxable as short- term capital gain.

- d) If there are no assets in the block and the block becomes empty but the WDV is not fully written off , then
- there will be no depreciation allowance and
  - existing WDV will be treated as terminal loss or short term capital loss due to cessation of the block as result of sales,

**Illustration :**

All assets in a block with opening WDV of Rs 4 lakh sold for Rs 1.50 lakh. The block becomes empty as there are no assets in it. No depreciation will be allowed and the balance of Rs 2.50 lakh will be treated as terminal depreciation or short term capital loss

- e) When the depreciation is allowed on the **actual cost/** WDV of the assets of the undertakings engaged in generation or destitution of power called power companies, following rules will apply:

- When an asset viz. any building, machinery, plant or furniture in respect of which depreciation is allowed, is sold, discarded, demolished or destroyed in the previous year not being the year in which it is first brought into use, terminal depreciation will be allowed.
- Terminal depreciation is the deficiency or shortfall between the written down value and the sales proceeds / or moneys payable including scrap value, insurance, salvage or compensation moneys payable in respect thereof.
- Terminal depreciation is not allowed in the year in which it was first brought to use.
- Such deficiency must be actually written off in the books of the assessee.
- Any surplus arising therefrom is called the balancing charge and taxed as income u/s 43.
- Any moneys received over and above the depreciation allowed will be treated as capital gains – u/s 50A.
- Under the old laws, actual cost motor cars was restricted to Rs. 25,000, although the actual cost could be higher. In such a case actual cost/deficiency will be taken proportionately in the ratio of actual cost and Rs. 25,000.
- Sale includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation.

**Illustrations**

1. A machine costing Rs. 1 lakh is sold for Rs 18,000.  
Depreciation of Rs 70,000 was written off on it.  
WDV : Rs.1,00,000- 70,000 = Rs 30,000.  
Deficit Rs. 30,000-18,000 = Rs 12,000, will be the terminal depreciation.
2. If the machine is sold for Rs. 50,000, the surplus of Rs 20,000 i.e. (Rs 50,000-30,000) will be the balancing charge- maximum to the extent of depreciation allowed.
3. If the sale price is Rs.1,25,000,  
then surplus of Rs 95,000 i.e.(1,25,000-30,000),  
Rs. 70,000 (up to the depreciation allowed) will be the balancing charge and the balance of Rs.25,000 will be treated as capital gain.

**4.3.8 Unabsorbed Depreciation- Section 32(2)**

Under section 32 (2), if amount of depreciation cannot be wholly or partly deducted in any previous year because of the lack or inadequacy of profits or gains, the amount of depreciation not deducted is treated as unabsorbed depreciation and allowed to be carried forward to the following previous year and deemed to be part of allowance for that year, and if there is no such allowance for that previous year, be deemed to be the allowance for that previous year, and so on for the succeeding previous years and so on. The unabsorbed depreciation is treated as part of the current depreciation and can accordingly be set-off against any other head of income even where the business has been discontinued.

**Illustrations**

1. Claim for depreciation allowable Rs 60,000, profit before depreciation is Rs 20,000.

Out of the claim for Rs 60,000, depreciation to the extent of available profits i.e. Rs 20,000 will be allowed and the balance of Rs 40,000 will be unabsorbed depreciation to be carried forward to the subsequent years.

2. Determine taxable income & unabsorbed depreciation :

Particulars	Rs.
Business Income (before depreciation)	13,00,000
Depreciation allowable as per Income Tax Act	18,00,000
Income from other sources	8,00,000

**Solution:**

Particulars		Rs.
Business Income before depreciation	13,00,000	NIL
Less: Depn. to the extent of profits	<u>13,00,000</u>	
Income from other sources	8,00,000	3,00,000
Balance of the current depreciation (18,00,000 -13,00,000)	<u>5,00,000</u>	
Taxable Income	Rs.	
		3,00,000

3. If the claim for depreciation is of Rs. 25,00,000.

**Solution:**

Particulars		Rs.
Business Income before Depn.	13,00,000	NIL
Depreciation to the extent of profits	<u>13,00,000</u>	
Income from other sources	8,00,000	NIL
Unabsorbed Depreciation for the current year to the extent of income	<u>8,00,000</u>	
Taxable Income	Rs.	NIL
Unabsorbed Depreciation to be carried forward to next year	Rs.	4,00,000

4. Ascertain value of block on 31-03-2018 :

**A.** Written down value on April 1, 2017

Particulars & Dep Rate)	Rs.
Plant A,B & C -20%	1,50,000
Plant D & E – 30%	2,40,000
Plant F – 40%	90,000
Building A & B -5%	2,00,000
Building C&D - 10%	7,00,000
Building E -Temporary Sheds E -100%	9,00,000

**B. Purchase during the previous year 2017-18**

Date	Particulars	Rs.
02/04/2017	Plant G -40%	60,000
01/05/2017	Plant H- 20%	20,000
01/06/2017	Furniture-10%	60,000
01/08/2017	Building G- 10%	5,00,000
01/09/2017	Computer-60%	2,00,000
01/10/2017	Franchise Rights -25%	8,00,000

**C. Sales during the previous year 2017-18**

DATE	PARTICULARS	(RS.)
31/10/2017	Plant C	25,000
31/01/2017	Plant D	15,000
01/06/2017	Furniture	50,000
06/03/2018	Building E	2,00,000

Temporary sheds were put to use in the previous year.

**Solution****Computation of Depreciation / Cost of Block**

Block	Rate	Block 1/04/17	Purchase	Sales	Block	Dep.	Block 31/03/18
Plant A/B/C /H	20%	1,50,000	20,000	25,000	1,45,000	29,000	1,16,000
Plant D/E	30%	2,40,000	-	15,000	2,25,000	67,500	1,57,500
Plant F/ G	40%	90,000	60,000	-	1,50,000	60,000	90,000
Building A& B,	5%	2,00,000	-	-	2,00,000	10,000	1,90,000
Building C/D /G	10%	7,00,000	5,00,000	-	12,00,000	1,20,000	10,80,000
Building E	100%	9,00,000	-	2,00,000	7,00,000	0	0
Furniture	10%	-	60,000	50,000	10,000	0	0
Computer	60%	-	2,00,000	--	2,00,000	1,20,000	80,000
Franchise rights	25%	-	8,00,000	-	8,00,000	2,00,000	6,00,000

**Note:** Depreciation not allowed on block of temporary sheds , which ceases to exist. Balance of Block Rs 6,00,000 will be treated as short term capital loss. Similarly, no depreciation will be allowed on furniture purchased and sold in the same year.

5. Opening WWDV of a block of assets consisting of three cars (rate of depreciation @ 20%) is Rs. 5,00,000. During the year 2017-18, new car is purchased for Rs. 10,00,000 and an old vintage car was sold for Rs. 15,00,000. Compute depreciation for A.Y. 2018-19.

**Solution**

**Computation of the value of Net Block**

Particulars	Rs.
Opening WDV of block-3 Cars)	5,00,000
Add: cost of new car purchased	10,00,000
Total-4 cars	15,00,000
Less: sales price -1 car Sold	15,00,000
Closing Balance of block -3 cars	0
Depreciation allowable- WDV is nil <i>although three cars still exist in the block</i>	0

6. What would be the position, if all of the above four cars were sold for Rs. 2,00,000 ?

**Solution**

**Computation of the value of Net Block**

Particulars	Rs.
Opening WDV of block-3 Cars)	5,00,000
Add: cost of new car purchased	10,00,000
Total-4 cars	15,00,000
Less: sales price -4 cars sold	2,00,000
Closing Balance -No Cars	13,00,000
Depreciation allowable ( empty block)	0
Short term capital loss on sale of cars	13,00,000

**4.4. Expenditure on Scientific Research –Sec. 35**

As per section 43(4), scientific research” means “*any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries*”. Following amounts are exempt under section 35.

**A. Expenditure on in-house Research relating to own business  
-Ss. 35(1) (i) ,(iv) and 35[2]**

Following are the salient features of the provisions;

1. Deduction is allowed in respect of both revenue and capital expense.
2. Revenue expenses include salaries of the research staff or research material used in scientific research

3. Capital expenses include expense on plant, equipment, construction of building other than cost of land.
4. Expense may be incurred during the previous year or and three years prior to commencement of business and the same will be allowed in the previous year in which the business is commenced.
5. Expenses should be incurred in relation to assessee's own business. Expenses not *related to assessee's own business would not be allowed*.
6. Deduction is available, *even if the relevant asset is not put to use for* research and development during the previous year.
7. An asset used in scientific research covered u/s 35, will not be eligible for depreciation, but when such asset is put to use for business after cessation of scientific research, it will be eligible for depreciation.
8. If a scientific research asset is sold, then the sales price of the asset or amount allowed as deduction u/s 35, whichever is less, will be treated as business income of the previous year in which the sale took place [section 41(3)], and the excess of sale price over cost (or indexed cost) of acquisition will be treated as "Capital gains".

### Illustrations

1. AB Ltd incurs expenses on scientific research related to its business@ Rs 1.50 Lakh per year from the financial years 2012-13 onwards. It commences the business during the financial year 2017-18.

Deduction u/s 35 will be allowed in A.Y. 2018-19 from Rs 6 lakh being the aggregate expenditure incurred in F.Y. 2017-18 year, in which the business was commenced and three years prior to that i.e. F.Y. 2014-15 to 2016-17. Expenditure incurred in F.Y. 2012-13 & 2013-14 will be ignored.

2. If a scientific research asset purchased on 01-01-2015 at a cost of Rs. 3 lakh, on which full deduction was allowed u/s 35 in A.Y. 2015-16 is sold on 31/03/2018 for Rs. 7 lakh, then Rs 3 lakh being the amount of original deduction allowed, will be charged as the business income and excess over the cost Rs. 4 lakh will be chargeable as capital gain in A.Y. 2018-19.

### B. Sum paid for research to others -Section -35(1)(ii)

an amount equal to **one and one half** times of any sum paid to a research association which has as its object the undertaking of scientific research or to any university, college or other institution approved to be used for scientific research.

**C. Sum paid to a R &D company – Section 35(1) (iia)**

Any sum paid to a scientific R&D company registered in India and approved by the prescribed authority to be used by it for scientific research

**D. Sum paid for social sciences etc.- Section 35(1)(iii)**

Any sum paid to any approved research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution to be used for research in social science or statistical research.

**E. Sum paid for approved research - Section 35(1)(iii)**

A sum equal to **One and one-half** times of the sum paid by an assessee to a National Laboratory or a University or an Indian Institute of Technology or a specified person with a specific direction that the said sum shall be used for scientific research undertaken under a programme approved in this behalf by the prescribed authority.

**F. Approved inhouse Research in drugs, bio- technology etc. -Section 35 (2AB)(a)**

A sum equal to one **and one-half** times of the capital or revenue expenditure (except **on land & Building**) incurred on scientific research (clinical drug trial, obtaining approval from any regulatory authority under law and filing an application for a patent);

- by a **company** ( not allowed to other assessees)
- engaged in the business of
  - **bio-technology or**
  - **manufacture or production of any article or thing**, not being an article or thing specified in the XI Schedule),
  - In-house **research & development facility** approved by the prescribed authority subject to the condition that the company enters into an agreement with it for co-operation in such research and development facility and fulfils such other prescribed conditions with regard to maintenance of accounts and audit thereof and furnishing of reports.

**Some other relevant points**

1. Goods specified schedule XI include beer, wine & other alcoholic spirits, tobacco products like cigars, cheroots, cigarettes, biris, smoking mixtures for pipes and cigarettes, chewing tobacco, snuff, cosmetics and toilet preparations, tooth paste, dental cream, tooth powder, soap, aerated waters, confectionery, chocolates, gramophones, record-players, projectors, photographic apparatus and goods, office machines and apparatus such as typewriters, calculating machines, cash registering machines, cheque writing machines, intercom machines and teleprinters but NOT Computers, furniture, made partly or wholly of steel , safes, strong boxes, cash and

deed boxes, strong room doors, latex foam sponge, polyurethane foam, crown corks, and other fittings of cork.

2. Cost of building will be eligible for deduction u/s 35(2).
3. The expenditure, on which weighted deduction is allowed under this section, will not be eligible for deduction under any other provisions of the Act.
4. "Expenditure on scientific research", in relation to drugs and pharmaceuticals, shall include expenditure incurred on clinical drug trial, obtaining approval from any regulatory authority under any Central, State or Provincial Act and filing an application for a patent.
5. Other important provisions :
  - (a) Scientific research by at the approved institutes *need not be related to the business of the assessee*
  - (b) Contribution eligible for weighted deduction under this section will not be eligible for deduction under other provisions of the Act.
  - (c) In case of any subsequent cancellation or withdrawal of approval to a notified university, college, research association or other institution or any approved programme is withdrawn, weighted deduction will not be denied to the assessee.
  - (d) Any violation of condition for approval will result into withdrawal of the deduction as a mistake apparent from record.
  - (e) On amalgamation the provisions will continue to apply to the amalgamated company as if the amalgamating company had not sold or otherwise transferred the asset.

#### **4.5. Amortisation of Preliminary Expenses-S 35D**

The provisions of section 35 D for Amortisation of Preliminary Expenses are summarised as under:-

##### **A. Eligible assessee :**

- a) an Indian company, or
- b) a resident non-corporate assessee.

A foreign company (regardless of its residential status and a non- resident or N.O.R non company entity are not eligible under this section

##### **B. Time and purpose of preliminary expenses –**

1. For Setting up an undertaking or business BEFORE commencement of business; or



2. in connection with:

- a) extension of an industrial undertaking; or
- b) setting up **a new industrial** unit

AFTER commencement of business.

Expenses incurred after commencement of business, in connection with extension of or setting up a non-industrial undertaking will not be eligible.

### **C. Eligible Expenditure:**

- (a) Expenditure in connection with:
  - preparation of feasibility report,
  - preparation of project report,
  - conducting a market survey (or any other survey necessary for the business of the assessee); or
  - engineering services related to the business of the assessee,
  - carried out by the assessee himself or by a concern approved by the CBDT.
- (b) Legal charges for drafting any agreement for setting up or conduct of the business.
- (c) Legal charges for drafting the Memorandum and Articles of Association. (M/A)
- (d) Printing expenses of the Memorandum and Articles.
- (e) Registration fees of a company under the Companies Act.
- (f) Expenses in connection with the public issue of shares or debentures of a company, underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus.
- (g) Any other prescribed expenditure.

### **D. Qualifying Expenditure:**

The aggregate expenditure exceeding the following limits will not be eligible for deduction under this section :-

- a) corporate assessee - Higher of the following :
  - 5% of cost of project; or
  - capital employed, whichever is more
- b) non-corporate assessee: 5 per cent of cost of project

### **E. Definitions of the terms**

#### **(i) Cost of project:**

Cost of project means the aggregate of actual cost of fixed assets appearing in the books of the assessee as on the last day of the previous year in which the business of the assessee commences.

Fixed assets include land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), or additional cost incurred after commencement of business in connection with extension or setting up an industrial undertaking) of fixed assets.

**(ii) Capital employed –**

Capital employed means the aggregate of the -

- issued share capital,
- debentures, and
- long-term borrowings,

as on the last day of the previous year in which-

- the business of the company commences, or
- additional capital borrowings etc. brought after commencement of business in connection with extension or setting up an industrial undertaking,

Long term borrowings for this purpose means moneys borrowed in India by any company from the Government or Financial institutions like ICICI, IFCI etc. or banks or foreign borrowings in connection with acquisition of plant and machinery repayable after a term of seven years or more.

**F. Amount of deduction:**

One-fifth of the qualifying expenditure is allowable as deduction in each of the five successive years beginning from the year of -

- commencement of the business, or
- completion of extension of industrial undertaking , or
- Commencement of production or operations by the new industrial unit.

**G. Other Points:**

1. Non- corporate assesseees are required to get their account audited for claiming deduction under this section.
2. On amalgamation/ demerger of the assessee company with other company, deductions can be claimed by the amalgamating or demerged company.
3. Amount deducted under this section will not be eligible for deduction under any other provision of the Act.

**Illustration**

ABC Ltd is an existing Indian company engaged in developing and providing computer software services. It incurs the following expenditure in connection with the setting up of a new unit. The project is complete in March 2018. Determine the amount deduction admissible u/s 35D.

Particulars	Rs
Preparation of project report	2,50,000
Market Survey	4,00,000
Legal charges for additional capital for new unit	3,50,000
Engineering services not approved by CBDT	5,00,000
Cost of the Project as on 31/03/2018*	50,00,000
Capital employed as on 31-03-2018	60,00,000

**Solution:****Eligible Expenditure:**

Particulars	Rs
Preparation of project report	2,50,000
Market Survey	4,00,000
Legal charges - additional capital for new unit	3,50,000
Engineering services not approved- ineligible	0
Total	10,00,000

**Gross Qualifying Amount:**

5% of cost of the project- (5% X 50,00,000)	2,50,000
5% of the capital employed (5% X 60,00,000)	3,00,000
Gross Qualifying Amount ( higher of the two )	3,00,000

**Qualifying Amount:**

Net qualifying amount Rs 3,00,000 being the lower of the following:

- I. Gross qualifying amount :Rs 3,00,000 or
- II. Actual amount of preliminary expenses: Rs 10,00,000

**Amount of Deduction:**

$\frac{1}{5}^{\text{th}}$  of the net qualifying amount ( $\frac{1}{5} \times 3,00,000$ ) Rs. 60,000 each for 5 assessment from A.Y. 2018-19 onwards.

**4.6. Specific deductions: - Section. 36**

Section 36(1) expressly allows the following specific deductions in computing taxable income under the head profits and gains of business or profession:

**4.6.1. Insurance premium –Section 36 (1) (i) / (ia) / (ib)**

Any amount of any insurance premium paid

- To cover risk of damage or destruction of business *stocks used in* business or profession; - Section 36(1)(i)

- on the *life of the cattle* owned by the milkmen being member of a primary co-operative society, by a federal milk co-operative society- Section 36(1) (ia)
- on the *health of his employees* by an employer, paid by any mode of payment other than cash (e. g. cheque) an approved scheme framed by the GIC or other insurer approved by the IRDA)- Section 36(1)(ib)

#### **4.6.2. Bonus or commission- Section 36(1)(ii):**

Any sum paid to an employee as *bonus or commission* for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission. U/s 43B, bonus or commission will be deducted only on payment thereof on or before the due date of furnishing return u/s139.

#### **4.6.3. Interest on capital borrowed - Section 36(1)(iii):**

Interest paid or payable on borrowed funds used for the purpose of business or profession.

Borrowed fund include recurring subscriptions paid periodically by shareholders / subscribers in Mutual Benefit Societies, which fulfill the prescribed conditions is deemed to be capital borrowed.

Interest (paid/payable in respect of capital borrowed for acquisition of an asset for extension of existing business or profession whether capitalized in the books of account or not) will be allowed only when an asset is put to use.

Interest for the period from the date of borrowing till the date when the asset is put to use will not be allowed but be added to the cost of the asset. This is in harmony with ICDS- IX, which mandates commencement of capitalization of interest from the date of borrowing of funds till the asset is first put to use, irrespective of whether acquisition of the asset is for extension of existing business or not.

#### **4.6.4. Zero Coupon Bonds- Section 36(1) (iiia):**

Discount on notified (by Central Government) Zero Coupon Bonds issued by an infrastructure capital company or infrastructure capital fund or a public sector company is allowable on *pro rata* basis provided no other benefit or payment is received in respect of such bonds before their maturity.

Zero Coupon Bonds are the bonds, which do not carry coupon rate of interest. Instead, the bonds are issued at a price lower than their redemption value. The difference between issue price and redemption value or the discount is allowed as deduction

on *pro rata* basis having regard to the period of life i.e. date of issue to the date of maturity or redemption of such bonds. Briefly, discount on Zero Coupon is amortised over the life time of the Bonds.

#### Illustration-

ICC Ltd. issues 50 lakh duly notified Zero Coupon Bonds of Rs. 500 each at a price of Rs. 404 on 01/01/2016. The bonds are redeemable at par on 31/12/2018. Show how the discount would be deducted from the total income of the company.

#### Solution:

Face value of Bond- Rs. 500

Issue price - Rs. 404

Discount offered Rs 500-404 = Rs 96

Total discount offered on 50 lakh bonds- Rs. 48 Crore

The tenure of the coupon is three years or 36 months.

*Pro rata* deduction to be allowed

A.Y. 2016-17- 3 months (01Jan-2016 -31March 2016)	3/36X48Cr	Rs.4 Cr.
A.Y. 2017-18 -12 Months	12/36X48Cr	Rs.16 Cr.
A.Y. 2018-19 -12 Months	12/36X48Cr	Rs.16 Cr.
A.Y.2019-20 -9 months April 31--Dec.31,2018 =9 Months	9/36X48Cr	Rs. 12Cr.

#### 4.6.5. Contribution towards RPF / approved superannuation fund -Section 36(1)(iv):

Any contribution paid by the assessee as an employer towards a recognised provident fund/ approved superannuation fund, subject prescribed limits and conditions and also subject to the provisions of S 43B.

#### 4.6.6. New Pension Scheme- (Section 36(1) (iva) :

Any contributions by employer to a pension scheme referred to in Section 80CCD (2) on account of employee to the extent of 10% of his salary plus dearness allowance but excluding all other all other allowances and perquisites.

#### 4.6.7. Approved gratuity fund- Section 36(1)(v):

Any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust;

#### 4.6.8. PF / ESIC -Section 36(1)(va)

Contribution received by an employer from his employees for crediting in any fund e.g. P.F. or ESIC and credited by the assessee to the employees' account in the relevant fund or funds on or before the due date prescribed under the relevant law.

Such contributions from employees are treated as income of the employer u/s 2(24)(X) when received and allowed as deduction when paid by the due date in terms of Section 43B.

#### **4.6.9. Death of animals-- Section 36(1)(vi)**

The difference between the actual cost to the assessee of the animals and the amount, if any, realised in respect of the carcasses or animals used for the purposes of the business/ profession otherwise than as stock-in-trade but died or become permanently useless for such purposes,

Where the animals are treated as stock in trade, the loss or profit is the part of normal sales and purchase, therefore this provision is not applicable.

#### **4.6.10. Bad debts- Section 36(1)(vii)**

Under Section S 36(1)(vii) and Section 36(2), any amount of bad debt or part thereof, which is written off as irrecoverable in the accounts of the assessee for the previous year is allowable subject to following conditions -

- (a) There is relationship of debtor and creditor.
- (b) The debt is incidental to the business or profession.
- (c) The debt has been considered in the computation of income, or it represents money lent in ordinary course of the business of banking or money-lending.
- (d) Bad debt is written off as irrecoverable in assessee's accounts in the previous year
- (e) Any debt written off but not allowed earlier may be deducted as bad debts
- (f) Bad debts will not include any provision for bad and doubtful debts made in the accounts of the assessee;
- (g) Any deficiency will be deductible in the previous year in which the ultimate recovery is made;
- (h) any such debt or part of debt written off as irrecoverable in an earlier previous year may be deducted if the deduction was not allowed on the ground that it had not been established to have become a bad debt in that year;
- (i) The assessing officer may deduct bad debts written off in the current year ; in an earlier previous year u/s 155(6) with in a period of 4 years if he is satisfied that the debt became irrecoverable in earlier years.
- (j) A bad debts can be claimed without recording in books of account as irrecoverable or bad as per second proviso to section 36(1)(vii) if the debt was considered in the computation of income as per the notified ICDSs.

**4.6.11. Provision by banks-Section 36(1) (viiia):**

U/s 36(1) (viiia) deduction is allowed to Indian scheduled & non-scheduled banks, financial institutions and non-banking financial companies in respect of provision for bad and doubtful debts upto the following limits namely :-

- 8.5% of total income by a scheduled Indian bank other non-scheduled bank,
- 5% of total income a public financial institution or a State financial corporation or a State industrial investment corporation and a foreign bank of the total income (computed before making any deduction under this clause and Chapter VI-A) and
- 10% of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner, and subject to certain conditions or
- 5% of total income of a non- banking financial company;
- 5% of Non-Performing Assets or NPAS in accordance with the RBI guidelines shown in the books of account of the bank on the last day of the previous year a bank at the option of the bank.

The deduction is subject to two conditions :

- (a) Assessee has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debts account.
- (b) Deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account.

**4.6.12. Special reserve-- Section 36(1)(viii)**

Under Section 36(1) (viii) financial institutions are entitled to a deduction upto 40% of their profits in respect of amounts transferred to a special reserve created and maintained by them subject to a ceiling of twice the amount of the paid-up share capital and of the general reserves.

Financial corporation mean

- a corporation which is engaged in providing long-term finance for industrial, agricultural development or development of infrastructure facility in India, or
- a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes,

Profit means profits derived from such business of providing long-term finance computed under the head Profits and gains of

business or profession before making any deduction under this clause.

**4.6.13. Promotion of family planning - Section 36(1) (ix)**

Vide Section 36(1) (ix)- expenditure incurred *bona fide* by a company for promotion of family planning amongst employees -

- in full if the expenditure is of revenue nature; and
- One fifth of capital expenditure for each of the five years beginning from the year in which it was incurred.

Unabsorbed family planning expenditure will be allowed to be carried forward and set off in the same manner as depreciation.

**4.6.14. Exp. by Statutory bodies - Section 36(1)(xii):**

Under Section 36(1)(x), revenue expenditure incurred, by any statutory corporation or a body corporate for the objects and purposes authorised by the Act under which it is constituted or established will be deductible.

**4.6.15. Cash Transaction Tax- Section 36(1)(xiii):**

Any amount of banking cash transaction tax paid by the assessee is deductible u/s 36(1) (xii):

**4.6.16. Credit Guarantee Fund -Section 36(1)(xiv)**

Any sum paid by a public financial institution by way of contribution to a specified credit guarantee fund trust for specified small industries will be deductible u/s 36(1)(xiv).

**4.6.17. Security Transaction Tax -Section 36(1)(xv):**

The security transaction tax (STT) paid by the assessee will be deducted u/s36 (1) (xv), if the income arising from taxable securities transactions is included in the income computed under the head "Profits and gains of business or profession.

**4.6.18. Commodity Transaction Tax Section 36(1)(xvi):**

The commodity transaction tax paid by the assessee will be deducted u/s36 (1) (xvi), if the income arising from such taxable commodity transactions is included in the income computed under the head "Profits and gains of business or profession.

**4.6.19. Expenditure by Co-operative Society for purchase of Sugarcane [Section 36(1) (xvii)]**

The expenditure incurred by a co-operative society engaged in the business of manufacture of sugar for purchase of sugarcane at a price, which is equal to, or less than the price fixed or approved by the Government, will be allowed as a deduction under Sec 36(1)(xvii).



**4.6.20. Losses as per IDCDS-[Section 36(1)(xviii)]**

Marked to market loss or other expected loss as computed in accordance with the notified income computation and disclosure standards

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**5. GENERAL DEDUCTIONS– SECTION 37:**


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Section 37 is the residual section, which provides for deduction of all the expenditure as under :-

- (a) The expenditure should be incurred *wholly and exclusively for the purposes of the business/ profession* carried on by the assessee, in respect of which income is computed under this head.
- (b) The expenditure, subject to the provisions of Section 43B, should be incurred during the previous year
- (c) expenses should be incurred after the business or profession is set up
- (d) Expenses must be revenue expenses in nature e.g. expenses by way of cost of raw materials, tools, spares , cost of labour, salary , brokerage, commission, legal fees, litigation expenses, professional tax, trade mark registration, lease rent or other business expenses incurred by the assessee;
- (e) The section excludes some expenses. Such expenses will not be allowed under this section. A list of such expenses is as under :-
  - i. Capital expenditure e.g. expenditure on acquisition or renovation of assets, conveyance or registration of land, eviction of a tenant etc.
  - ii. Personal expenses e.g. income tax or wealth tax, drawings or household expenses of the assessee;
  - iii. Expenses expressly allowed in Sections 30 to 36;
  - iv. Expenses incurred for any purpose which is an offence, or which is prohibited by law, e.g. penalty, bribery, composition money paid in respect of any offences or breach of law or penal interest under any law etc.
  - v. Expenses on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party specifically excluded from the purview of Section 37(2B)
  - vi. any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013

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## 6. SPECIFIC DISALLOWANCES– S.40-40A-43B

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**6.1.** Some expenses are not allowed be deducted, while computing the business income for a number of reasons such as :-

- (a) Not satisfying the inherent conditions attached with the allowance. E.g. Personal and capital expenses will be disallowed u/s 37, which allows only revenue expenses incurred wholly and exclusively in the course of business or profession.
  - (b) Absolute disallowances for policy reasons such as political advertisement and CSR expense, which are expressly disallowed u/s 37.
  - (c) Defaults such as non-deduction of tax at source.
  - (d) Deferment or time factor. E.g., unpaid taxes, bonus etc. covered u/s 43B are disallowed in the year of accrual.
  - (e) Personal element, e.g., drawings by an individual, interest and remuneration in case of a firm.
  - (f) Reasonableness e.g. unreasonable payments to relative u/s 40A(2),
  - (g) Mode for payment e.g. Cash payments u/s 40A (3)
  - (h) Partial disallowance due to ceilings, e.g. interest and remuneration payable to partners.
  - (i) Express disallowance , e.g. CST expenses
- These disallowances are discussed below,

### **6.2. Disallowance in case of any assessee – Section 40(a)**

#### **1. *Payments to Non-Residents without TDS* [S. 40(a)(i)]**

Any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable,—

(A) outside India; or

(B) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source and such tax has not been deducted or, after deduction, has not been paid on or before the due date for filing return of income u/s 139 (1).

The amount so disallowed will be allowed as a deduction in computing the income of a subsequent previous year in which such tax has been paid.

**Illustration**

A pays commission of Rs. 1,00,000 to a Non-Resident for the previous year 2017-18, on which tax of Rs 20,000 is required to be deducted. Show whether the commission will be allowable in the following situations.-

- a) A does not deduct tax at source at all.
- b) A deducts tax at source but not does not pay the tax to the Government in time.
- c) A deducts tax at source but not and pays it to the Government in time.
- d) A pays the tax to Government after deducting the same in December 2018

**Solution:**

In cases (a) and (b) commission will be disallowed u/s 40(a)(i) because the assessee fails to deduct the TDS or pay the amount of TDS to the Government.

In case(c) deduction will be available in A.Y. 2018-19.

In case (d), deduction will be allowed in A.Y. 2019-20.

**2. Payments made to residents without TDS [S.40(a)(ia)]**

30% of any sum paid or payable to a resident, on which tax is deductible at source and such tax has not been deducted or, after deduction, has not been paid on or before the due date for filing return of income u/s 139 (1) shall be disallowed u/s 40(a)(ia).

Such disallowance will not be made if the recipient of the income has paid the due tax thereon and as a result thereof the assessee is not deemed to be an assessee in default u/s 201(1).

However, the sum so disallowed (30%) will be allowed as a deduction in computing the income of a later previous year in which such tax has been paid:

**3. Payment on account of fringe benefit tax [S. 40(a)(ib)]:**

4. Any sum paid on account of any rate or tax levied on the profits or gains of any business/ profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.-[S. 40(a) (ii)];

**5. Payment on account of *wealth-tax*. [S. 40(a) (ia)]**

6. Any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively on; or which is appropriated, directly or indirectly, from, a State Government undertaking by the State Government. [Section 40(a) (iib)]

7. *Salary payable outside India* or to a non-resident, and if the tax has not been deducted or deducted and has not been paid therefrom under Chapter XVII-B.

However, such salaries will be allowed as a deduction in the year in which the tax has been paid in respect of the salary. [Section 40(a) (iii)]

8. Any payment to a provident or other fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund, which are chargeable to tax under the head Salaries. Such payment will not be allowed as a deduction if tax has not been deducted in the year in which such payments have been made. However, these payments will be allowed as a deduction in the year in which tax has been paid.[S.40(a) (iv)]

8 Any tax actually paid by an employer on perquisites u/s10 (10CC)-[S. 40(a) (v)]

### 6.3. Disallowances in the case of any firms- S.40(b)

#### **a. Remuneration to partners– S. 40(b)**

Following are the provision about remuneration payable to partners of a firm assessable as such namely:-

(i) Any payment of remuneration to any partner ,

a. who is **not a working partner**; or

b. who is a **working partner**, but such payment of remuneration is **not authorised** by, or is not in accordance with, the terms of the partnership deed;

c. a working partner but payment of remuneration though authorised, relates to any period falling **prior to the date of such partnership deed** or

For this purpose, "working partner" means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner;

(ii) any payment of remuneration, to a working partner though authorised and otherwise allowable, if the remuneration to all partners in aggregate exceeds the following limits:

<b>Book Profits</b>	<b>Remuneration allowable</b>
on the first Rs. 3,00,000 of the book profit or in case of a loss	Rs.1,50,000 or 90 % of the book-profit, whichever is more;
on the balance of the book-profit	60 % of the book profits

*“Book-profit”* means the net profit, as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit. In other words, Book Profit means net profit before providing for remuneration to partners.

*“Remuneration”* means “any payment of salary, bonus, commission or remuneration by whatever name called.

**b. Interest to Partners-S. 40(b)**

- (i) Any payment of *interest* to any partner which is *not authorised* by or is not in accordance with, the terms of the partnership deed; or
- (ii) *Interest*, to partner thought authorised, relating to any *period falling prior to the date* of such partnership deed or
- (iii) Interest in accordance with the deed of partnership but in excess of the amount calculated at the rate of twelve per cent simple interest per annum;

Following points are also relevant in this regard:-

- (i) A partnership deed may, at any time during the said previous year be amended to provide for payment of interest but such amendment will be applicable only prospectively. Retrospective effect cannot be given to such terms.
- (ii) The interest will be considered in the same capacity in which it is paid.

**Illustrations**

1. A is a partner in a firm as a trustee of B. A advance his personal money as well as B's money to the firm. The firm pays interest to A in his personal capacity and as the representative or trustee of B.

Interest payable to A in his capacity of trustee will be considered u/s 40(b). Interest paid in his individual capacity will be ignored. On the other hand, if A is a partner in his individual capacity, then interest paid to him in his representative capacity shall be ignored.

2. For the financial year 2017-18, a firm shows net profit of Rs 50,000 after debiting the following amounts:

- Remuneration to A (not a working partner) Rs 50,000.
- b) Remuneration to B- Rs 5,00,000 for the full year. The firm has made provision for his remuneration by a partnership deed dated 01/7/2017

c) Interest to partners @ 18% p.a. Rs. 90,000.

Compute the business profits for A.Y. 2018-19

**Solution:**

<b>Computation of Profits from Business -A.Y. 2018-19</b>		
<b>Particulars</b>		<b>Rupees</b>
<i>Business Profits as per P/L A/c</i>		50,000
<i>Add back- Salaries &amp; Interest paid to partners (50,000+5,00,000+90000)</i>		6,40,000
<i>Book Profits before interest &amp; remuneration</i>		6,90,000
<i>Less: Interest authorised by partnership deed restricted to 12% i.e. 90,000 X 12/18</i>		60,000
<i>Book Profit Before Remuneration</i>		6,30,000
<i>Remuneration to Partners ( Lowest of the following )</i>		3,75,000
<i>A –( Nor working partner</i>	<i>NIL</i>	
<i>B- Actual Remuneration</i>	<i>5,00,000</i>	
<i>Remuneration allowed from the date of deed - 9 months from 01/07/2017 to 31/03/2018 5,00,000 X9/12</i>	<i>3,75,000</i>	
<i>Maximum allowable</i>	<i>4,75,200</i>	
<i>90% of Rs 300000 of book profit Rs 2,70,000</i>		
<i>60% of the balance book profit of Rs (6,42,000-3,00,000)- 2,05,200</i>		
<i>Profits from Business</i>		<i>2.55,000</i>

**c. Remuneration/Interest by an association of persons(AOP) /body of individuals (BOI)-S. 40(ba):**

Any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by an association of persons (AOP) /body of individuals (BOI) to a member of such association or body.

“Association or “body” does not include a company or a co-operative society or a society registered under the Societies Registration Act, 1860, or other registered charitable trusts.

**Following points are also relevant:-**

- a. Unlike a firm, no part of interest paid to a member is allowable in case of an association or a body. Hence, capacity or status of the member in such AOP or BOI is relevant. Accordingly
  - i. Interest paid by a member in his representative capacity to the association or body or *vice versa* shall be ignored, if he is a member in his individual capacity.

- ii. Conversely , Interest paid by a member in his individual capacity to the association or body or *vice versa* shall also be ignored if he is a member in his representative capacity
  - iii. Interest paid by a member in his representative capacity to the association or body or *vice versa* shall be considered if he is a member in his representative capacity.
  - iv. Interest paid by a member in his individual capacity to the association or body or *vice versa* shall be considered if he is a member in his individual capacity
- b.** Where, interest is paid to a member on funds borrowed by him, the disallowances will be only on the net amount receivable by such members.
- c.** Remuneration or interest to members of AOP/BOI are not allowed to be deducted for computing income from business and profession

#### Illustration

X is a member of BOI. X borrows a sum of Rs. 1,00,000 from market with interest rate of 12% and advances it to the BOI. BOI pays Interest @ 15% p. a. to X. Determine the amount to be disallowed.

#### Solution:

Particular	Rs
Interest payable by BOI to X 15% on Rs 1,00,000	15,000
Interest payable by X on his borrowing 12% on Rs 1,00,000	12,000
Disallowable u/s 40(b) ( Net)	3,000

#### 6.4. Disallowances In the case of all assesses –S.40A

S. 40A provides for disallowance of certain expenses in certain circumstances. Most of these disallowances are anti-avoidance measures in nature and as such are overriding and prevailing. Sec 40A (1) expressly states that:-

*“The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head "Profits and gains of business or profession".*

The disallowances are discussed as under:-

##### 1. Excessive payment to relatives -Section 40A (2)

U/s 40A(2)(a) Any expenditure resulting in any payment to any specified person may be disallowed to the extent it is excessive or unreasonable in the opinion of the assessing officer having

regard to the market value of the goods or services and the benefit to the business or profession.

The section specifically excludes domestic transaction referred to in section 92BA, if such transaction is at arm's length price as defined in 92F (ii).

Sec 40A (2) (b) gives a long list of specified persons, which is summarised as under :-

<b>A. Persons connected with the assessee</b>	
<b>Status of assessee</b>	<b>Specified person</b>
Individual	any relative of the assessee;
Company	any director or his relative
Firm	any partner or his relative
Association of Persons	any member or his relative
Hindu Undivided Family	any member or his relative
<b>B. Sister concerns</b>	
Entity holding substantial interest of the assessee	
<i>Person holding a substantial interest in the business or profession of the assessee</i>	<i>Specified person</i>
Individual	Individual or his relative
Company	any director or his relative
Firm	any partner or his relative
Association of Persons	any member or his relative
Hindu Undivided Family	any member or his relative
<b>C. Persons connected with the sister concerns</b>	
If partner of a firm, or director of company or member of a HUF , AOP hold substantial interest , then such company , firm, AOP or HUF will be the specified person also other directors, partners , members and their relatives will be the specified persons (The above table will be applicable to the concerns of where such persons are partners directors or members)	
<b>D : Reverse connection :</b>	
Where assessee or his relatives, or if the assessee is a company, firm , HUF ,AOP its directors , members or partners etc. or their relatives ), hold substantial interest in the business of other individual, company, firm, AOP or HUF, the latter will be treated as the specified persons .	

**“Relative”** in this context means husband, wife, and brother, sister or any lineal ascendant or descendent of the individual.

A person holding **“Substantial interest”** means a person holding 20% voting power in a company at any time during the previous year or twenty per cent of the profits of other concern viz proprietary concern, HUF, AOP, BOI etc.



**Illustration**

Determine the specified persons u/s 40A(2)

- a. A is an individual. His wife is a specified person
- b. A is a firm having B, C & D as partners, B, C & D and their relatives will be the specified persons
- c. If A is a HUF with B, C & D as members, B, C & D and their relatives will be the specified persons
- d. If A is a AOP with B, C & D as members, B, C & D and their relatives will be the specified persons
- e. If A is a Company with B, C & D as directors B, C & D and their relatives will be the specified persons.
- f. In the above cases B is a company, then B and all directors of B will be the specified persons.
- g. If C is a firm, then C and all partners of C will be the specified persons
- h. If D is A HUF or AOP, all the members as well as D will be the specified persons.

2. Payments exceeding Rs 10,000 /35,000 other than by way of crossed cheque or demand draft – S. 40A(3) /(3A)

U/s 40A (3)/ (3A), in respect of any expenditure, payment exceeding Rs. 10,000 (Rs. 35,000 in cases of payments made for plying, hiring or leasing goods carriages) during a single day is made otherwise than by an account payee cheque drawn on a bank or account payee bank draft, or use of electronic clearing system (ECS) through a bank account, exceeds ten thousand rupees, no deduction shall be allowed in respect of such expenditure.

Following points require attention:

1. The disallowance is on total payment, if it crosses the limit of Rs. 10,000/ 35,000 i.e. on payments of Rs 10,001/ 35,001, or more.
2. Limit of Rs. 10,000/ 35,000 will be considered with reference to the aggregate of all payments made in a single day.
3. If expenditure is allowed in past on the basis of its accrual and subsequently cash payment is made in respect of such liability, in excess of Rs. 10,000/ 35,000, such excess payment will be deemed to be the business profit in the year of payment.
4. Rule 6D gives some exceptions, when disallowance will not be made if the payment exceeding Rs 10,000 /35000 and is made otherwise than by way of crossed cheque/ bank draft etc. some of these circumstances are: new buyer, bank holiday, lack of banking facility, etc.

5. S 40A (4) forbids a person to raise an issue in a suit for being offered payment by account payee cheque or draft and not in cash.

**Illustrations:**

1. Legal fee provided during the financial year 2015-16 for Rs. 80,000 is paid by cash on 31.03.2018.

**Solution**

Legal fee of Rs 80,000 allowed as deduction in A.Y. 2015 - 16 will be deemed to be the profit of the A.Y. 2018-19, when it was paid in cash.

2. A makes a payment of Rs. 12,000 by a bearer cheque for purchase of goods and claims that disallowance u/s 40A(3) is not applicable and even if it is applicable, it will be restricted only on Rs. 2,000 being the amount exceeding Rs. 10,000. Examine his claim.

**Solution**

If payment in excess of Rs 10,000 is made otherwise than by an account payee cheque or draft etc., entire payment of Rs 10,000 will be disallowed without any basic limit. Bearer cheque and cash are not acceptable modes of payment.

**3. Provision for Gratuity-S. 40A (7)**

Any provision for payment of gratuity to employee on their retirement or termination of their services for any reason will not be allowed u/s 40A (7). But if such provision is made by contributing to an approved gratuity fund or for payment of gratuity that has become payable during the previous year, will be allowed as deduction.

Hence, gratuity is allowed as a deduction only when it has become due and payable. However, once the provision for gratuity has been allowed as deduction in any year, then any subsequent payment thereof will not be deductible again.

**4. Provision for non- statutory funds -S.40A (9)**

U/s 40A (9), deduction will not be allowed in respect of any sum paid by the assessee as an employer towards the setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, society or other institution for any purpose, except where such sum is paid for the purposes and to the extent provided by or under S. 36(1)(iv)/ (v) or as required by or under any other law for the time being in force like approved provident/gratuity funds etc. However, any *bona fide* sum actually spent out of such fund will be allowed as deduction u/s.40 (10). Further, u/s S.40 (11) assessee will be entitled to receive back the unutilised part of any such fund/assets.

### **5. Unpaid Liabilities-Section 43B**

Section 43B provides an exception to the mercantile system of accounting in respect of taxes and other specified expenses, which will be allowed in the previous year, in which they are actually paid irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him. The section covers any sums payable by the assessee:-

- (a) by way of tax duty, cess or fee, by whatever name called, under any law for the time being in force, or
- (b) as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees, or
- (c) as bonus or commission to employees- u/s 36(1)(ii); or
- (d) as interest on any loan or borrowing from any public financial institutions i.e. ICICI, IFCI, UTI, IDBI LIC or a State financial corporation or a State industrial investment corporation, in accordance with the terms and conditions of the agreement governing such loan or borrowing , or financial arrangement; or
- (e) as interest on any loan or advances from a scheduled bank, a co-operative bank other than a primary agricultural credit society, a primary co-operative agricultural or rural development bank accordance with the terms and conditions of the agreement governing such loan or advances; or
- (f) as an employer in lieu of, any leave at the credit of his employee; or
- (g) as user , to Indian Railways for use of railway assets.

Sec 43B provides will not be applicable if :—

1. The payment is actually made on or before the due date of submission of return of income; and
2. the evidence of such payment is submitted along with the return of income.

In brief, Section 43B provides that

1. Sums accrued and paid within the same previous year would be allowed in that year ;
2. Sums accrued in one year and paid in the following year but before the due date of filing will also be allowed on accrual basis on submission of proof of payment.
3. Other sums will be allowed only on cash basis and not on mercantile basis.

Following table summarises the position:

<b>Application of Section 43B</b>	
Case	Year of Deduction
Accrued and paid in same year	Year of payment/accrual ; as both are same
Paid after the end of the year in which it is accrued but on or before the due date of submission of return of income for that year and the proof of deposit is submitted along with the return of income	year of accrual
Any other time not covered above, or proof not attached with return	Year of payment

### Illustrations

1. ABC Limited pays sales tax for the financial year 2018-19 before 30/09/2018. Determine the assessment year in which the sales tax may be claimed as deduction.

### Solution

Tax is paid before due date for filling return of income viz. 30/09/2018. Hence, it will be allowed on accrual basis in A.Y. 2018-19.

2. ABC Ltd pays GST for the previous year 2017-18 on 01/10/2018. In which assessment year will it be allowed?

### Solution

ABC Ltd. pays tax after the due date for filling return of income. Deduction will be allowed only in the year of actual payment year 2018-19 relevant to A.Y. 2019-20.

3. From the following record of GST payments made during F.Y. 2017-18, show the year in which the GST will be deducted from the business profits of the assessee.

S. No.	Date of payment	Rupees
1	02/05/2017	40,000
2	20/07/2017	75,000
3	16/08/2017	60,000
4	05/12/2017	30,000
5	12/06/2018	35,000
6	02/12/2018	20,000
7	Outstanding	90,000
	Total	3,50,000

**Solution**

Date of payment	Rupees	A.Y. in which deducted	Reason
02/05/2017	40,000	2018-19	Due & paid in same F. Y.
20/07/2017	75,000	2018-19	
16/08/2017	60,000	2018-19	
05/12/2017	30,000	2018-19	
12/06/2018	35,000	2018-19	Paid before the due date of return if proof of payment is furnished along with return of income
02/12/2018	20,000	2019-20	Delayed , paid after due date of return
Outstanding	90,000	NA	Allowable in the year when paid

**1. ILLUSTRATIONS:**

1. From the following Income & Expenditure account of Mohan, lawyer for the year ending March 31, 2018, compute the total income of the firm.

To Admin. Expenses	18,50,000	Professional Receipts	65,00,000
To Depreciation	80,000		
To Remuneration to Proprietor	2,50,000	By Other fees	90,000
To Interest on proprietor's capital	1,60,000		
To Net Profit	42,50,000		
Total	<b>65,90,000</b>		<b>65,90,000</b>

**Other Information:**

- Expenses include salary paid in cash Rs. 2,00,000 and transport Rs 25,000 to a single party on a single day .
- Depreciation allowable u/s 32 Rs. 3,50,000

**Solution**

Computation of Total Income of Mohan for A. Y. 2018-19

Net profit as per Income & Exp account	42,50,000
Add: Expenses not allowable	
40A(3)- Cash salary paid over Rs. 10,000	2,00,000
Remuneration to proprietor	2,50,000
Interest to proprietor	1,60,000
	48,60,000
Less: Depreciation u/s 32 (3,50,000-80,000)	2,70,000
Total Income	45,90,000

2. From the given Trading and P & L A/c of A for the year ended 31st March 2018, compute taxable income for the A. Y. 2018-19

Particulars	Rs.	Particulars	Rs.
To Opening Stock	75,000	By Sales	20,00,000
To Purchases	15,00,000	By Closing Stock	85,000
To Gross Profit	5,10,000		
Total	20,85,000	Total	20,85,000
To Salaries	2,50,000	By Gross Profit	5,10,000
To Sales Commission	40,000	By Bad Debts Recovery	25,000
To Sales Tax	35,000		
To General Expenses	5,000		
Advance Income Tax	54,000		
To Interest on Loan	42,000		
To Interest on Capital	18,000		
To Depreciation on Furniture & Fittings	4,000		
To Advertisement	16,000		
To Free Distribution of Samples	3,000		
To Insurance premium on Life of Partners	8,500		
To Printing & Stationery	3,500		
To Net Profit	56,000		
Total	5,35,000	Total	5,35,000

**Additional information:**

1. Salaries include Rs. 40,000/- paid to proprietor.
2. General Expenses are incurred for the purposes of pleasure tour of proprietor and his family members to Goa.
3. Income Tax includes Rs. 14,000 paid for the proprietor.
4. Bad Debts recovered were earlier allowed as a deduction.
5. Cash expenses over Rs 35,000 for carriage of Rs. 40,000 and over Rs 10,000 in respect of other expenses Rs 60,000.

**SOLUTION:**

Computation of Total Income of X & Y Co. for A.Y. 2018-19		
Particulars	Rs.	Rs.
Profit as per Profit and Loss Account		56000
Add: Exp. disallowed /considered separately		
Salaries to the proprietor	40000	
General Expenses incurred for personal purpose by the partners	5000	
Cash expenses 40A(3)	100000	
Income Tax (Advance)	54000	
Interest on Capital	18000	
Insurance on Life of Proprietor	8500	225500
Business income		281500

**7. SELF-EXAMINATION QUESTIONS:**

- 1) Define and explain "Business".
- 2) Explain any six deductions which are specifically allowed as a deduction while computing income from business or profession.
- 3) Give a detailed note on depreciation
- 4) Is Depreciation always allowed on Written down Value?
- 5) What happens, when block ceases to exist?
- 6) Discuss the tax treatment when block comes to zero.
- 7) What are the incomes chargeable under the head "Profits and Gains of Business or Profession"?
- 8) Explain the items of expenses, which are expressly not allowed as deductions while computing income from "Profits and Gains of Business.
- 9) Explain "while computing Profits and Gains of Business or Profession" "Section 37(1) is the residuary section to claim deduction.
- 10) Explain expenses allowed on payment basis U/s 43B.

11) State the disallowance under Section 40A (3) if a purchase bill of Rs 45,000 was immediately paid by cash. (*Ans: Rs. 45,000*)

12) State whether following expenses are allowed as a deduction or not while computing income from business or profession, if not, give reasons:

- a. Interest paid outside India wherefrom no tax has been deducted nor there is any representative assessee.
- b. Income tax paid by the firm.
- c. Salary paid outside India wherefrom no tax has been deducted nor there is any representative assessee.
- d. Salary paid to a partner.
- e. Guest House expenses.
- f. Advertisement expenses.
- g. Contribution to Gratuity Fund.
- h. Interest on borrowed capital.

(*Ans: Item f & h only allowable, d allowed subject to book profits*)

13) Discuss the admissibility and/ or inadmissibility of the following expenditure under the Provision of Income Tax Act, 1961

- a. A technical consultant was paid consultancy fee of Rs. 20,000 in cash by assessee and a deduction was claimed towards the expenditure.
- b. A senior advocate conducted the Income tax proceeding before the Income Tax authority and was paid Rs 18,000.
- c. Provision made for gratuity as per actuary valuation of Rs 1,00,000.
- d. A sum of Rs 1,30,000, was paid towards sales tax liability in the account for the year ending 31.3.2016
- e. Stock-in-trade was lost to fire amounting to Rs 10,000/- and was debited to Profit and Loss Account. (*Ans : a, b & e allowable*)
- f. Discuss the implication of the following transactions in the case of a doctor running a nursing home:
- g. Amounts received from the employees of the nursing home as contribution towards Provident Fund for the month of March 2018 paid to the PF - Rs 25,000 in December 2018
- h. Cash paid for purchase of medicines –Rs 50,000  
(*Ans. 25000 Income u/s/ 43 B (2) Rs 50,000 disallowed u/s 40A (3)*)
- i. Are the following expenses allowable as deduction under section 37(1): (a) Litigation expenses for official purposes?  
(b) Expenses relating to purchase of stationary for official



purpose and (c) interest on loan taken for the purpose of paying income-tax. (Ans; 1&2 allowable)

- 14) From the P/L A/c of X for the year ending 31-03-2018, ascertain total income for the assessment year 2018-19 :

Expenses	Rs.	Income	Rs.
General expenses	13,400	Gross profits	3,64,500
Bad debts	22,000	Commission	8,600
Advance tax	21,000	Brokerage	37,000
Insurance	600	Sundry receipts	2,500
Salary to staff	26,000		
Salary to X	32,000		
Interest on overdraft	4,000		
Interest on loan to Mrs. X	42,000		
Interest on capital of X	23,000		
Depreciation	48,000		
Advertisement exp.	7,000		
Contribution to RPF	13,000		
Net profit	1,60,600		
Total	4,12,600	Total	4,12,600

**Other information:**

(A) Depreciation allowable is Rs. 37,300 as per the I.T. Rules.

(B) Gen. exp. include Rs. 500 for arranging a party to a friend

(Ans  $160600 + 21000 + 32000 + 23000 + 48000 - 37300 + 500 = 247800$ )

- 15) From the following data, calculate the depreciation admissible to an individual carrying on business, for A.Y. 2018-19

Particulars	%	WDV
Factory Building	10	5,00,000
Plant & Machinery	20	8,00,000
Addition to Plant		1,00,000
Sale proceeds of Plant (cost 1 lakh)		5,00,000
Furniture & Fixtures	10	1,00,000
Motor Car	20	60,000
New computer	60	60,000

(buildg. Rs. 50,000, P&M . 60,000, Comp. Rs.36000, Furni. Rs.10,000 & Car Rs.12,000)

- 16) From the following, ascertain depreciation admissible and other liabilities, if any. In respect of the previous year relevant to the AY 2018-19.

Particulars	Plant & Mach	Building
Rate of Depreciation	25%	10%
WDV at the beginning of the year	Rs2,50,000	Rs 5,00,000
Additions during the year	Rs 3,00,000	Nil
Sales during the year	Rs10,00,000	Rs 2,00,000

(Ans. P&M Rs. Nil Rs. 2,00,000 Short term capital gain, Building Rs. 5,000)

- 17) X Ltd. owns two plants A & B on 1/4/ 2017 (depreciation-15% per cent) with opening depreciated value of the block Rs. 2,37,000. It purchases Plant C with depreciation -15% on 31/5/ 2017 for Rs. 20,000 and sells Plant A on 10/04/2017 for Rs 10,000, Plant B on 12/12/2017 for Rs. 15,000 and Plant C on 1/03/2018 for Rs. 24,000. Determine the WDV of the block as on 31/03/2014 and also the depreciation

{Ans.  $237000 + 20000 - 49000 = 208000$  Short Term Capital Loss, block empty, Depn -NIL}

- 18) Compute depreciation for A.Y. 2018-19 from the following:  
 Plant & Machinery A, B & C – WDV on 1/4/ 2017 Rs. 5,00,000 rate of dep.15%. Plant D purchased on 12/06/2017 Rate of dep. 15% for Rs. 40,000. Plant A sold on 8/12/ 2017 for Rs. 1,60,000. (Ans Value of Block  $500000 + 40000 - 160000 = 380000$  Dep. 57000)



## **CAPITAL GAINS**

### **Sections 45, 48,49,50,54**

#### **Synopsis:**

1. Introduction and Objectives
2. Basis of charge
3. Types of capital assets
4. Types of capital gains
5. Period of holding
6. Computation of capital gains
7. Value of consideration
8. Cost of transfer
9. Cost of acquisition
10. Fair Market Value
11. Transactions covered u/s 49(1)
12. Cost of improvement
13. Indexed cost of acquisition /improvement
14. Transactions not regarded as transfer
15. Illustrations
16. Self-assessment questions

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### **1. INTRODUCTION AND OBJECTIVES**

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Tax on capital gains is being an exception to the rule that income tax is a tax on income of the law is very complex. Accordingly, the lesson takes a detailed look into different aspects of tax treatment of capital gains contained in section 49-55 to the extent mandated by the syllabus.

The lesson also seeks to explain, concept of “Capital Asset”, “Transfer”, what constitutes a capital asset and what is not a capital asset, types of capital gains, concept of indexation, computation of capital gain and other machinery provisions.

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### **2. BASIS OF CHARGE**

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#### **2.1 Capital Gains defined – Section 45**

As per section 45, which is the charging section, “any profits or gains arising from the transfer of a capital asset effected in the previous year shall be the income of the previous year in which the transfer took place”.

Accordingly, the section applies on (i) 'transfer' of (ii) a "capital Asset"(iii) during the "previous year" (iv) resulting in some gain or loss.

Every asset may not be a 'capital asset' nor every movement of a capital asset from one person to another can be called "transfer". If the two ingredients do not co-exist simultaneously, there will be no liability for tax u/s 45.

E.g., profit on transfer of a personal motorcar will not be chargeable as capital gain because motorcar being a personal effect is not a 'capital asset' u/s 2(14).

Similarly, where the shares are registered in the name of a legal heir on the death of a shareholder, there will not be any capital gain as devolution or transmission of an asset unto heirs by succession is not transfer u/s 2(47).

## 2.2 Capital asset

"Capital asset" is defined in section 2(14) as:

"Property of any kind held by an assessee, whether or not connected with his business or profession," but does not include -

- a. **any stock-in-trade, consumable stores or raw materials** held for the purposes of his business or profession ;
- b. **personal effects**, i. e. movable property including wearing apparel and furniture held for personal use by the assessee or any member of his family dependent on him, but excludes (a) Jewellery; b) archaeological collections; (c) drawings; (d) paintings; (e) sculptures; or (f) any work of art.

For this purpose, "Jewellery" includes:

- (a) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel;
- (b) precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;

Although jewellery is a movable property held for personal use, it is deemed as a "capital asset". The definition covers only ornaments, not other articles like silver or gold utensils, which are neither "jewellery nor ornaments".

- c. **Agricultural land** in India, not being land situate in :
  - a. areas not in the jurisdiction of a municipality, municipal corporation notified area committee, town area

committee, town committee, or by any other name or a cantonment board or cantonment board having population of 10000 or more and

- b. in any area within the distance, measured aerially, from the local limits from any area of municipality etc. as above-

Distance not more than	Population of the area of municipality etc. as per last published census
2 KM	10,001 – 1,00,000
6 KM	1,00,001 – 10,00,000
8 KM	More than 10,00,000

- d. Special Bearer Bonds, 1991  
 e. 6 1/2 per cent Gold Bonds, 1977  
 f. 7 per cent Gold Bonds, 1980  
 g. National Defence Gold Bonds 1980  
 h. Gold deposit Bonds under old Deposit Scheme 1999

Further, “property” includes any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

### 2.3 Transfer – Section 2(47)

In any inclusive definition, section 2(47) states “Transfer in relation to capital assets includes the following:-

- (1) sale, exchange or relinquishment of the asset ;  
 Relinquishment of a right means transfer of a right in favour of another person e.g. sale of right to subscribe shares.
- (2) extinguishment of rights on the capital asset;  
 Extinguishment of rights results in cessation or destruction or cancellation of rights in a capital asset like surrender of tenancy right for e.g. buyback of shares results in extinguishment of shares.
- (3) compulsory acquisition under any law;
- (4) conversion of capital asset into stock in trade of a business;
- (5) maturity or redemption of a zero coupon bond issued by an infrastructure capital company, a fund or a public sector company notified by the central government in respect of which, no payment or benefit is received before maturity or redemption;
- (6) any transfer involving the allowing the possession of an immovable property u/s 53A of Transfer of Property Act, in part performance of the contract for transfer of that property;
- (7) any transaction involving transfer of membership of a group, association housing society, company, etc., which

have the effect of transferring or enabling enjoyment of any immovable property or any rights therein in any manner whatsoever;

- (8) distribution of assets on the dissolution of a firm, body of individuals or association of persons;
- (9) transfer of a capital asset by a partner or member to the firm or AOP, whether by way of capital contribution or otherwise;
- (10) transfer under a gift or an irrevocable trust of shares, debentures or warrants allotted directly or indirectly to its employees under the ESOP scheme of the company as per the guidelines of the Central Government.

Sections 47 and 47A list out transactions, which are not regarded as “transfer” e.g. transfer upon reorganisation of business entities like amalgamation, demerger, gift, will etc.

#### **2.4 Other receipts chargeable to capital tax**

As per section 45, “capital gain” covers following other receipts, namely :-

##### **a) Insurance money**

Money or other assets received during the previous year from an insurer on account of damage to or destruction of a capital asset, as a result of:

- I. Flood, typhoon, hurricane, cyclone, earthquake or other convulsions of nature or
- II. Riot or civil disturbance or
- III. Accidental fire or explosion or
- IV. Action by an enemy or action taken in combating an enemy

##### **b) Conversion of capital asset into stock**

Transfer by way of conversion, by the owner of a capital asset into, or its treatment by him as stock-in-trade of a business carried on by him but is chargeable to tax in the previous year in which such stock-in-trade is sold or otherwise transferred by him.

##### **c) Interest in securities**

Transfer made by a depository or a participant of beneficial interest in any securities during the previous year in which such transfer takes place.

##### **d) Transfer of asset as capital to firm , AOP or BOI**

Transfer of a capital asset made by a person to a firm or other association of persons or body of individual (not being a company or a co-operative society) in which he is or becomes a partner or member by way of capital contribution or otherwise; in the previous year , in which the transfer takes place.

**e) Transfer of asset on dissolution of firm , AOP or BOI**

Transfer of a capital asset by way of distribution of capital assets on dissolution of a firm or association of persons or body of individuals (not being a company or co-operative society) or otherwise, in the previous year in which the transfer takes place.

**f) Compulsory Acquisition**

Transfer of capital asset by way of compulsory acquisition under any law is chargeable to tax in the previous year in which such compensation or part thereof is received.

Any additional compensation shall be taxable in the previous year, in which it is actually received.

If any court, tribunal or any authority subsequently reduces the initial compensation, the capital gains assessed in the year of receipt of initial compensation or enhanced compensation will be amended to re-compute the capital gains with reference to such reduced compensation.

**g) Repurchase of Units of Mutual Funds**

Transfer of capital asset being the units of UTI or other mutual funds issued under the Equity-Linked Savings Scheme on the repurchase thereof by the mutual fund will be taxed in the year of such repurchase.

**h) ESOP /ESOS**

Sale value of the shares issued to employees under an equity stock option plan/scheme as reduced by the cost of acquisition / indexed cost of acquisition of the shares will be taxed in the year of such issue.

**i) Buyback- Sec.-46A**

The value of a consideration received by the shareholder from a company under a scheme to buyback its own shares u/s 77A of the Companies Act, 1956 as reduced by the cost of acquisition /indexed cost of acquisition will be taxed in the year **of** buyback.

**j) Joint Development Agreement(JDA)-Sec.- 45(5A)**

The value of the capital asset (land or building or both) transferred (by an individual or a HUF) under a registered specified agreement called Joint Development Agreement(JDA) to develop real estate for a consideration of a share being land and building or both, whether with or without or part payment of consideration in cash ; shall be the stamp duty valuation on the date on which the competent authority issues a completion certificate for the entire property and capital gain will be chargeable accordingly on that date.

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### 3. TYPES OF CAPITAL ASSETS

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Capital assets are of two types - short term capital asset and long term capital asset depending upon the period for which, it is held by the assessee before its transfer. Period of holding is 12, 24 or 36 months depending upon the asset.

**a) Short Term Capital Asset (STCA)- Section 2(42A)**

- (i) As a general rule, short-term capital asset means a capital asset held by an assessee for less than 36 months before it is transferred.
- (ii) The period of 36 months is reduced to 12 months for the following assets :-
  - (a) Equity or preference shares quoted,
  - (b) Securities like debentures, government securities and notified derivatives, which are listed in recognised stock exchange u/s 10-23(D),
  - (c) Units of UTI
  - (d) Units of equity oriented mutual funds
  - (e) Zero coupon bonds
- (iii) the period of holding is reduced to 24 months for the following assets
  - (a) unlisted Shares,
  - (b) immovable property ( land, building or both)

**b) Long Term Capital Asses (LTCA)**

Long term capital means a capital asset, which is not a short-term capital asset. In other words, a capital asset will be a long term asset if it is held for more than 12, 24 or 36 months before it is transferred.

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### 4. TYPES OF CAPITAL GAINS

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Capital gains arising on the transfer of a capital asset will be short term capital gain or long term capital gain depending upon the type of the asset which is transferred that is:-

**(i) Short Term Capital Gain (STCG)**

Capital gain arising on transfer of a short term capital asset (asset held by an assessee for less than 36/ 24/12 months) will be short term capital gain and any loss arising on the transfer of short term asset will be short term capital loss – Section 2(29B)

Further, capital gains arising on sale of long term business, assets in a block in case of a slump sale u/s 50 and surplus left in a block on transfer of all depreciable assets in the block would be treated as a short term capital gain (loss).



**(ii) Long Term Capital Asses (LTCG)**

Long-term capital gain is the gain arising on transfer of a long-term asset or an asset held by an assessee for 36/12/24 months or more. Conversely, any loss arising on transfer of long-term asset will be long-term capital loss – Section 2(42B)

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**5. PERIOD OF HOLDING- Section 2(42A):**


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Type of capital gains depends upon the period of holding of an asset by the assessee before its transfer. The period of holding is determined on the basis of the following principles :-

1. In case of shares held in company in liquidation, the period subsequent to the date of liquidation will not be included. Period of holding will stop running on date of liquidation.

**Illustration**

A buys some shares in on 01-01-2016 of a company, which soon thereafter, goes into liquidation on 01-06-2016. The liquidator settles the claim on 01-03-2018. The period of holding of the shares will be five months from 01-01-2016 to 01-06-2016. The period after 01-01-2016 will not be included.

2. Where, a capital asset becomes the property of the assessee in circumstances like death, gift etc. as mentioned in section 49(1), the period for which the previous owner held such capital asset will also be included in the period of holding.

**Illustration**

A purchase a flat on 01-01-2016. A dies on 01-01-2018 leaving the flat to his wife B. B sells the flat on 20-03-2018. The period of holding will include the holding by A from 01-01-2016 to 01-01-2018. Since it is held for more than two years it will be a long term asset giving rise to LTCG/ (LTCL).

3. In case of shares of an amalgamated company allotted to a shareholder against the shares in an Indian company, which was amalgamated, the period for which the assessee held the shares in the amalgamated company will also be included.

**Illustration**

R purchased 1000 shares of S Ltd on 12/11/2016. On 31/12/2017, S Ltd amalgamated with H Ltd. Under the scheme of amalgamation, original 1000 shares in S Ltd were converted into 300 shares of H Ltd. R sells these 300 shares of H Ltd. on 01/01/2018. The period of holding of new shares will include the holding during the period 12/11/2016 to 31/12/2017. The share s will LTCA and the capital gain from the sale of these shares will be LTCG.

4. The period of holding shall start from the date of allotment on rights issue of shares or other securities subscribed by the

assessee by such person or other person in whose favour such right has been renounced.

5. In case of *renunciation of a right*, for the person who has acquired the rights, the period shall be reckoned from the date of the offer of such rights by the company or institution.

6. In case of a *bonus issue*, allotted without payment on the basis of holding of any other financial asset, period shall be reckoned from the date of allotment of such financial asset.

7. In case of shares in a resulting company received under a scheme of demerger of a company, the period for which the *shares in the demerged company* were held by the assessee will also be included.

8. In case of shares of trading or clearing rights of a recognised stock exchange acquired by a person under its demutualisation or corporatisation, the period for which, such person was a member will also be included.

9. In case of equity shares allotted under demutualisation or corporatisation of a recognised stock exchange in India, the period for which such person was a member will also be included.

10. Period of holding of other capital assets will be decided according to the rules framed by the CBDT in that regard. As per the CBDT clarification, date of transfer/ acquisition of shares will be considered on the basis of the brokers' note / date of contract or date of allotment and FIFO (First in First Out Basis) in the case of Demat Accounts.

11. In case of security or sweat equity, allotted or transferred by the employer free of cost or at concessional rate to this employees including former employees, popularly called as ESOP, the period shall be reckoned from the *date of their allotment or transfer*.

12. The period of holding of units acquired in the consolidated scheme of mutual fund shall include the period for which the units in consolidating schemes were held by the assessee.

13. The period of holding of a capital asset, being share or shares of a company, acquired by a non-resident assessee on redemption of GDRs would be reckoned from the date on which a request for such redemption was made.

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## 6. COMPUTATION OF CAPITAL GAINS- SEC. 48

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### 6.1. General Rule

As per section 48, the income under the head "Capital Gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :-

- (i) Expenditure incurred wholly and exclusively in connection with such transfer;
- (ii) The cost of acquisition of the asset and the cost of any improvement thereto:

### 6.2. Long Term Capital Gains

Where the capital gain is to be computed in respect of a long term asset, instead "cost of acquisition" and "cost of improvement", "indexed cost of acquisition" and "indexed cost of improvement" are to be deducted subject to following exceptions, when benefit of indexation of cost will not be available, viz.-

**a.** Capital gain on transfer of shares or debentures of Indian company by a non-resident will be computed by converting the cost of acquisition, full value of consideration and expenses incurred for transfer into originally utilised foreign currency and reconverting capital gain into Indian currency.

**b.** Capital gain on transfer of bonds and debentures although they may qualify to be called long term capital assets. This is because bonds and debentures are normally issued and redeemed at par and if benefit of indexation is given, it will always give capital loss.

**c.** In case of slump sale u/s 50B.

This implies that

$STCG = (\text{Sales Consideration} - \text{Expenses on Transfer}) - (\text{cost of acquisition} + \text{Cost of Improvement})$

$LTCG = \text{Sales Consideration} - \text{Expenses on Transfer}) - (\text{Indexed cost of acquisition} + \text{Indexed Cost of Improvements})$

**Note:** The STCG / LTCG are subject to deductions/exemptions under sections 54, 54B, 54D and 54EC, 54ED, 54F 54G etc., of which syllabus covers only section 54.

### 8.3. Depreciable Capital Assets– Sec. 50

Where a capital asset has been sold or transferred and in respect of such capital asset depreciation had been allowed, the tax treatment will be as under:-

A. Written down value(WDV) of the block at the beginning of the year increased by the cost of acquisition of any new asset falling in the same block purchased during the year and incidental expense on transfer the asset purchased , will be the WDV of the block. There will be no capital gain. i.e. (opening WDV+ new purchase- sales proceeds of asset sold) =WDV

B. If sales consideration exceeds the WDV of the block as increased by the new purchase and the incidental expense on transfer, such excess consideration will be treated as short term capital gain.

C. If the resulting figure is negative, it will be treated as short term capital loss.

D. If block ceases to exist, i.e., all assets in a block are sold, the WDV in the block will be short-term capital loss.

Capital gain will arise only if the full value of sale price exceeds the aggregate of the following:-

- Incidental expenses on transfer
- The written down value of the block at the beginning of the previous year.
- Cost of acquisition of the asset falling in that block of assets during the previous year

The resulting figure will be short term capital gain or short term capital loss. If block cease to exist, no further deduction will be available, nor any further deduction will be allowed.

### **Illustration:**

From the following particulars in respect of a block of assets :

- a. Opening WDV Rs 80,000
- b. Cost of new asset purchased Rs 20,000
- c. Rate of depreciation 15%

Compute the depreciation or capital gain if-

1. No asset was sold during the year , or
2. Value of the consideration for asset sold was
  - (a) No asset sold
  - (b) Rs 70,000
  - (c) Rs. 1,00,000
  - (d) Rs. 1,20,000
  - (e) All assets in the block sold for Rs 40,000

**Solution:**

Particulars	a	b	c	d	d
	Rupees				
Opg. WDV	80,000	80,000	80,000	80,000	80,000
Add-New Purchase	20,000	20,000	20,000	20,000	20,000
Total	1,00,000	1,00,000	1,00,000	1,00,000	1,00,000
Sales	0	70,000	1,00,000	1,20,000	40,000
WDV /Gain	1,00,000	30,000	0	(20,000)	60,000
Depreciation	15,000	4,500	0	0	0
STCG	-	-	-	20,000	-
STCL	-	NA	-	NA-	60,000
Clos. WDV	85,000	25,500	0	0	0

*Notes: No depreciation in case b as WDV in block comes to zero and in case e, all the assets are sold, hence the block ceases to exist. Residual WDV of Rs. 60,000 will be short term capital loss.*

**5.4. Depreciable assets of power undertaking: Sec 50A**

In respect of a depreciable assets of an undertaking engaged in generation or distribution of power or energy, short-term gain/loss will be computed with reference to the cost of acquisition as adjusted u/s 43(6).

In case of a composite agreement for sale of a factory building along with the land, depreciable asset will be building not the land because land is not a depreciable asset.

*Land will be considered as general capital asset giving rise to long term or short term capital gain depending upon the period for which it is held.*

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**7. VALUE OF CONSIDERATION- SECTION 48**


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“Full total value of consideration” means the value received or accruing because of the transfer.

It indicates the whole of the price; in terms of money or money's worth or both; bargained for between the parties *inter se*, which accrues or arises upon transfer of a capital asset.

*The capital gains will be chargeable on accrual basis, not on cash basis.* Actual receipt of the value is irrelevant.

Further, “full value of consideration” does not refer to the market value of the asset transferred or the adequacy of the price except in some specific cases, where fair market value accruing or arising on transfer of a capital asset is required to be ascertained e.g. u/s 50C, 50CA etc. Some specific cases are considered below.

(i) In case of transfer of a property without consideration or out of natural love and affection; there will no capital gain. However, the transaction will be subject to the provisions of section 56,

(ii) in case of transfer by a company as a gift or under an irrevocable trust of any shares, debentures, or warrants allotted directly or indirectly to its employees under employees' stock option scheme ( ESOP/ESOS ) as per the guidelines issued by the Central Government, full value of the consideration will be the fair market value of shares on the date of transfer

(iii) In case of a transfer resulting in exchange of two or more assets, full value of consideration of the assets transferred will be equal to the fair market value of the asset received.

### Illustration

A exchanges his flat for B's car. In this case "Full total value of consideration of A's flat will be the fair market value of the car transferred by B and vice versa.

(iv) Amount of any insurance claims received in respect assets destroyed in natural conditions like tsunami, floods, earthquakes, would be deemed the full value of consideration.

Section 45 specifies the year of the capital gain liability and the value of consideration arising or accruing in some cases, which are given in the following table :

Sub Section and the nature of the transaction	Previous year when taxed year of	Value of consideration
(1) Sale or Transfer	Sale or transfer	Sales consideration
(1A) Damage or Destruction	Receipt of claim money	Money received or fair market value
(2) Conversion into stock	Sale of stock	Market value on the date of conversion
(2A) Transfer of securities by depository	Transfer determined on FIFO basis	Consideration for transfer
(3) Transfer as capital contribution in firm / AOP / BOI	Transfer	Value credited in capital account
(4) Transfer on dissolution of firm/AOP/BOI	Transfer	Fair market value on date of transfer
(5) Compulsory acquisition	Receipt of compensation	Initial compensation or enhanced compensation as the case may be
(6) Repurchase of mutual fund units	Receipt or discontinuation of scheme	Repurchase price

### Illustration

On 01/04/2001 Ashok bought personal gold ornaments for Rs 2 lakh. On 01/01/2010, he converted the same into his stock of his new jewellery showroom. The fair market value of

the ornaments was Rs. 5 lakh on that day. On 31/03/2018 , he sold the ornaments for Rs. 12 lakh. Determine the tax incidence.

### Solution

Transfer takes place on 01/01/2010, when personal ornaments were converted into business stock. The amount of Capital gain will be:

Full values of consideration [FMV 01/01/2010]	5,00,000
Less-Indexed Cost of Acquisition( revised) [2,00,000 X 148/100]	2,96,000
Long Term Capital Gain arising on 01/01/2010 chargeable in A.Y. 2018-19, when actual sales of the ornaments took place along with business profit of Rs 12 lakh- 5lakh= Rs 7 lakh	2,04,000

## 8. COST OF TRANSFER – SECTION 48(1)

While computing the capital gain, expenditure incurred wholly and exclusively in connection with the transfer of asset will be deducted from the total value of consideration subject to the following conditions:

- (i) The expenses should be incurred wholly and exclusively in connection with the transfer.

Lawyers' fee for transfer, brokerage, travelling expenses for transfer, advertisement, stamp duty and registration fee ,if paid by the seller etc. will be allowable but normal administrative expenses like salary of staff for upkeep or maintenance of property will not be allowable .

- (ii) The expenses must not be claimed as deduction as expenditure under any other head.

- (iii) No expenses will be allowed in respect of share transactions covered under the securities transaction tax.

## 9. COST OF ACQUISITION – [SEC 48 - 46 & 49]

Cost of acquisition is the sum total of amounts spent for acquiring a capital asset including the following-

- (i) price paid by the assessee for purchase of property ; or
  - (ii) fair value on the date of exchange , of the asset transferred in exchange, where the asset is acquired in exchange for another asset ; and
  - (iii) expenses incurred on transfer, registration, stamp duty etc.
- The relevant provisions are given as under:-

- A. (1) Where asset becomes the property of the assessee by a mode referred to in sec. 49(1) before 1.4.2001**

- i. Cost of acquisition is the actual cost to the previous owner or the fair market value as on **1.4.2001** at the option of the assessee.
  - ii. Where , actual cost to the previous owner cannot be ascertained, fair market value on the date on which the asset became the property of the assessee will be taken
  - iii. Where there are successive transfers under this mode, the reference to the previous owner will mean last of such previous owners who has acquired the assets by a mode otherwise than any of the modes u/s 49(1).
  - iv. In these case the period for which asset was held by the previous owner is also taken into consideration to determine the period for which the asset was held.
- A. **(2)** Where asset becomes the property of the assessee by a mode referred to in Sec. 49(1) **on or after 1.4.2001**
- i. Cost of acquisition is the actual cost to the previous owner.
  - ii. Where the actual cost to the previous owner cannot be ascertained, fair market value on the date on which the asset became the property of the assessee will be taken.
  - iii. Where there are successive transfers under this mode, the reference to the previous owner will mean last of such previous owners who has acquired the assets by a mode otherwise than any of the modes u/s 49(1).
- B. **(1)** Where asset becomes the property of assessee by a mode other than referred to in Sec. 49(1) **before 1.4.2001**:

Cost of acquisition is the actual cost to the assessee or the fair market value as on **01-04-2001** at the option of the assessee. The base date has been advanced from 01/04/1981 to 01/04/2001 by the Finance Act, 2017.

- B. **(2)** Where asset becomes property of assessee by a mode other than referred to in S 49(1) on and after 1.4. 2001.  
Cost of acquisition is the amount actually spent by the assessee in acquiring the actual asset i.e. the actual cost of acquisition.
- C. Where the asset becomes the property of the assessee subject to tax u/s 56 :
- Where any asset (cash, movable property, or shares of closely held company's immovable property) is received without consideration or for consideration less than the fair market value, and as a result becomes taxable u/s 56, then, the cost of acquisition of such asset will be the cost taken u/s 56 for income tax purposes. The section is discussed in detail in the next chapter. The provision is apparently enacted to avoid double taxation of the same property.



**D. Specific Cases:****i. Earnest money forfeited – Section 51;**

Any earnest money received in advance and forfeited by the assessee, due to failure in negotiation will be taxable as “income from other sources”.

Prior to A.Y.2016-17 such deposit was reduced from the actual cost of acquisition or the fair market value as on 1.4.2001 as the case may be and cost of acquisition was adjusted accordingly. .

**Illustration-11**

A purchased a flat on 01-06-2010 for Rs. 28 lakhs. In 2014, A received advance of Rs 6 lakh from a prospective buyer. Later, the negotiations failed, and A forfeited the advance money. The flat was ultimately sold in July, 2017 for Rs 55 lakh. Calculate the indexed cost of acquisition and the taxable capital gains on the sale of the building.

**Solution:**

Particulars	Rs	Rs
Sales Consideration		55,00,000
Actual Cost	28,00,000	
Less: Earnest money forfeited-sec 51 (then not taxable)	6,00,000	
Net Actual Cost	<u>22,00,000</u>	
Indexed Cost of Acquisition $22,00,000 \times \frac{272}{167}$		35,83,233
Long Term Capital Gain		19,16,767

*272 and 167 are the index for F.Y. 2017-18 & 2010-11 respectively. w.e.f. A.Y.2017-18, earnest money would be taxable, and cost of acquisition will not be adjusted*

**ii. Self-generated assets**

Self-generating assets such as goodwill, patents, copyrights, tenancy rights, which have no actual cost of acquisition incurred, were judicially held to be not liable to capital gain tax as the cost of acquisition was nil. The position has been partially changed and the amended section *provides that “in relation to the goodwill of a business, trade mark or brand name associated with a business, tenancy rights, loom hours, route permits, right to manufacture or produce any process any article, cost of acquisition shall be taken as the purchase price if such price is paid, or nil, if such price is not paid.”* As a result, effectively, entire sale proceeds less expenses on transfer of self-generated assets will be treated as capital gain.

**iii. Financial assets – shares and other securities**

Where an assessee becomes entitled to subscribe any additional securities, known as ‘Rights’ or where additional shares are issued as bonus i.e. without any payment, the cost of acquisition shall be as follows:

- a. Amount actually paid for acquiring such asset by way of *subscription to the securities* or
- b. Amount actually paid for acquiring such asset by way of exercising his right or entitlement.
- c. NIL; where rights are renounced for a price, then consideration for renouncement of rights will be the amount of capital gains as reduced by transfer cost, if any.
- d. Amount paid to the renouncer of rights entitlement and amount paid to the company, which has allotted the rights shares
- e. NIL in case of bonus shares. Sales proceeds of bonus share will be liable to capital gain as reduced by transfer costs, if any. However, if the bonus shares have been acquired prior to 01-04-2001, then the share market value of bonus shares as on 01-04-2001 will be treated as the cost of acquisition.
- f. Fair Market Value on the date of distribution of capital assets by a Company u/s 46 (2).
- g. Cost of acquisition of the original asset Consolidation, division, conversion, reconversion of share into stock or vice versa and where such cost cannot be reasonably ascertained, the fair market value.
- h. Cost of acquisition of the original shares held by the shareholders in the demerged company as reduced by the amount arrived at u/s 49 (2C).
- i. Cost of acquisition of original membership of a recognised stock exchange when equity share/s allotted to shareholders of recognized stock exchange under a scheme of demutualisation or corporatisation of the exchange – Sec. 55(2)(ab)
- j. NIL in respect of trading or clearing rights of stock exchange.
- k. *Pro rata* amount i.e. the amount which bears to the Cost of Acquisition of the shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger will be the cost of acquisition of Shares in the resulting company– Section 49 (2C).
- l. Stock option Specified security is taxable as a perquisite u/s 17(2) – Section. 49 (2AA)
- m. Actual cost of acquisition in all the other cases.

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## **10. FAIR MARKET VALUE**

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Fair market value, in relation to a capital asset, means the price that the capital asset would ordinarily fetch on sale in the open market on the relevant date.

If the assessee has acquired the asset prior to 01-04-2001, he has the option of substituting the fair share market value of the asset as on 01-04-2001 instead of actual cost of acquisition.

Fair market value is adopted, where ascertainment of actual cost is not possible; assets distributed on liquidation have already been dealt with at their appropriate places. Some other cases are considered below:

**a) Conversion of capital asset into stock-in-trade**

When an assessee converts a personal capital asset into stock-in-trade of his business, such conversion will give rise to notional capital gains or loss on the date of such conversion, but it will be chargeable to tax, when such capital asset (stock after the conversion) is actually sold.

For this purpose, the fair market value of the capital asset on the date of conversion will be treated as notional sale consideration from which the cost of acquisition / indexed cost of acquisition will be deducted to get the capital gain.

Later, when this converted capital asset is sold, there will be business profit or loss i.e. actual sale proceeds less notional fair market value taken, as cost will be the taxable business profit or loss.

**Illustration**

Ramesh converts his personal jewellery into the stock in-trade of his business on 31/10/2011. The jewellery was sold on 28/02/2018 for Rs. 50 Lakh. FMV of the jewellery was Rs. 10 lakh on 01/04/2001 and Rs. 30 Lakh on 31/10/2011.

**Solution:**

FMV on 31/10/2011 – deemed sales consideration	Rs 40.00 lakh
Less - indexed cost of acquisition on 01/04/2011 - Rs.10 lakh X 184/100	Rs.18.40 lakh
Capital gain on 31/10/ 2011 taxable on 28/02/2018 (when sold)	Rs 21.60 lakh
Business profit on 28/02/2018 Rs50-30) lakh	Rs 20.00 lakh

**b) Introduction of capital asset by a partner:**

When a partner transfers his personal asset by way of his capital contribution in a partnership firm, the amount credited to his capital account in respect of this capital asset will be treated as sales proceeds in the hands of the partner from which the cost or indexed cost of acquisition will be reduced to get the amount of capital gains or loss taxable in the hands of the partner.

**c) Takeover of assets by the partner on dissolution of the partnership firm**

When a partner is allocated a capital asset upon the dissolution of a firm the fair market value of the capital asset on the date of dissolution of the firm will be treated as sales proceeds from which the cost of acquisition or indexed cost of acquisition, as the case may be, will be reduced to get the amount of taxable capital gains in the hands of the firm.

**d) Compulsory acquisition of capital asset**

Where there is compulsory acquisition of capital asset by the government or any government authority under law, there will be a taxable capital gain or loss in the year of such compulsory acquisition. However, such capital gain will be chargeable only in the year, in which the compensation is received. If the compensation is enhanced later, then the receiver of such additional amount is chargeable to capital gains in the previous year in which such additional compensation is received. If the compensation amount is subsequently reduced, the capital gain already charged will be recalculated as if it were a mistake apparent from the record u/s 155.

**d) Amount received on liquidation of the company:**

Out of the money received by the shareholder on liquidation of the company, a part of the amount will be treated as deemed dividend under section 2(22) and the remaining amount less the indexed cost of acquisition or cost of acquisition, as the case may be, is taxable as capital gains on sale of the shares.

**f) Sale of shares under depository system**

Where an assessee has any depository account and any shares are sold from the depository account, then such cost of acquisition of the shares sold will be determined on FIFO i.e. on first in first out basis. It will be assumed that the assessee's shares deposited in the account first were sold first and accordingly the cost of acquisition, date of acquisition and the period of holding will be calculated.

**g) Stock Lending**

Any share given under the stock-lending scheme approved by SEBI in this behalf will not give rise to any taxable capital gain.

**h) Corporatisation of Stock Exchanges**

In case any person transfers equity shares allotted to him as member of a recognised stock exchange in India under a SEBI approved scheme of corporatization of stock exchanges, his original cost of acquisition of membership of the stock exchange will be the cost of acquisition for computation of capital gains on those shares.

**i) Demerger:**

Cost of acquisition of shares in the resulting company in case of a demerger shall be determined as follows:-

$$\frac{\text{Cost of shares of demerged company} \times \text{Net book value of assets}}{\text{Net worth of demerged company before demerger}}$$

The cost of acquisition of the original shares in the demerged company shall be reduced by the amount calculated as above

**j) Taxation of capital gains of listed shares**

Share are treated separately by the provisions of sections 111A/112, whereby an assessee is given the option to either pay a lump-sum tax of 18%+3% cess and forego the benefit of indexation or alternatively pay regular tax under the normal provisions including indexation .

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**11. TRANSACTIONS COVERED U/S 49(1)**


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As per section 49, where a capital asset became the property of the assessee in certain circumstances,

- the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it,
- as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be.

These circumstances are as under:-

- (i) any distribution of assets on total or partial partition of a Hindu undivided family;
- (ii) under a gift or will;
- (iii) by succession, inheritance or devolution,
- (iv) distribution of assets on the dissolution of a firm, body of individuals, or other association of persons, where such dissolution had taken place at any time before 01/04/1987, or
- (v) distribution of assets on the liquidation of a company, or
- (vi) under a transfer to a revocable or an irrevocable trust, or
- (vii) under any such transfer as is referred to in clause (iv)/ (v)/ (vi)/ (via) / (viaa)/(viab)/ (vib) /(vica)/ (vicb)/ (vicc)/ (xiii)/ (xiiib) or clause (xiv) of section 47;
- (viii) Conversion of personal asset of the assessee as the joint property of the HUF referred to in section 64(2).
- (ix) under a gift or will not being gift or transfer through an irrevocable trust of shares, debentures or warrants allotted by a company directly or indirectly to its employees under a Central Government approved employees stock option/ scheme (ESOP /ESOS). In such

cases, the market value of the shares, debentures or warrants gifted or transferred to the irrevocable trust on the date of transfer will be treated as the sale proceeds for the purpose of capital gains.

- (x) by succession, inheritance or devolution.
- (xi) distribution of assets on liquidation of company.
- (xii) under a revocable or irrevocable trust.
- (xiii) transfer by a wholly owned Indian subsidiary company from its holding company and by a parent company to its 100 per cent Indian subsidiary company.
- (xiv) any transfer in scheme of amalgamation by the amalgamated company from the amalgamating company.
- (xv) by Hindu undivided family where one of the members has converted its self acquired property into a joint family property.
- (xvi) Transfer of units by unit holders on consolidation of plans within a mutual fund scheme;
- (xvii) Redemption by an individual of sovereign gold bonds issued by RBI.

### Illustration

Ram gets a flat as his share in property of his HUF on partition. The HUF had purchased the flat on 01-04-2001 for Rs 10 lakh. A sells the flat for Rs. 35 lakhs on 1st November 2017. What will be A's liability for tax?

### Solution:

- (i) There will be no liability for capital gain on 01-04-2001 as *partition of HUF is exempted u/s 49.*
- (ii) On 1 November 2017 relevant to A.Y. 2018-19, *cost and date of acquisition are same as previous owner (HUF) i.e. Rs. 5 lakh and 01-04-2001.* The capital gain will be as under:

	Rs.
Sales consideration	35,00,000
Indexed cost of Acquisition $10,00,000 \times \frac{272}{100}$	<u>27,20,000</u>
LTCG	<u>07,80,000</u>

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## 12. COST OF IMPROVEMENT:-SECTION 55(1)(B)

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Cost of improvement includes all the expenses incurred to increase the value of the capital asset. Cost of Improvement in relation to capital asset means any expenditure or cost of capital nature incurred by (a) *the assessee* or (b) *the previous owner* in case of an asset acquired by an assessee in any of the circumstances u/s 49(1):-

- for substantially improving or raising the value of the capital asset or
- in making addition or alteration to capital asset after date of acquisition or
- for any expenditure incurred to protect or complete the title of the capital asset or
- to cure the title of the property or remove any defect from the title.

Following additional points are noteworthy in this regard :

- (i) Where a capital asset was acquired prior to 01-04-2001 and its fair market value (FMV) as of 01-04-2001 is substituted in place of cost of acquisition, cost of improvement incurred *prior to 01-04-2001 will be ignored* by the assessee or the previous owner. However, capital expenditure incurred by the assessee or the previous owner *after 01-04-2001* in making any additions or alterations to capital asset will be included in cost of improvement. This is because the FMV on 01/04/2001 must be including the cost of improvement made upto that date.
- (ii) In any other case all the capital expenditure incurred in making in additions or alterations to the capital asset by the assessee after it become his property.
- (iii) There will be no cost of improvement to goodwill, right to manufacture or produce or process any articles or right to carry on any business.
- (iv) Expenditure deductible from the income from house property will not be included in cost of improvement.

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### 13. INDEXED COST OF ACQUISITION / IMPROVEMENT

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Explanation iii to section 48(iii), defines indexed cost of acquisition, indexed cost of improvement and cost inflation index as under:-

- (a) **"Indexed cost of acquisition"** means:-

an amount which bears to the cost of acquisition the same proportion as cost inflation index for the year in which the asset is transferred, bears to the cost inflation index for the first year in which the asset was held by the assessee or for the year beginning on the 1st day of April, 2001, whichever is later. In other words –

**Indexed cost of acquisition =**

Cost of Acquisition X CII ( the year of Transfer)

CII in the year of acquisition or 01-04-2001 , whichever is later

- (b) **"Indexed cost of any improvement"** means:-

an amount which bears to the cost of improvement the same proportion as cost inflation index for the year in which the asset is transferred bears to the cost inflation index for the year in which the improvement to the asset took place; i.e. .

### **Indexed Cost of Improvement**

$$\frac{\text{Cost of Improvement} \times \text{CII (the year of Transfer)}}{\text{CII in the year of Improvement}}$$

(c) **"Cost Inflation Index" (CII)** for any year means:-

Such Index as the Central Government may, having regard to seventy-five per cent of average rise in the consumer price index for urban non-manual employees for that year, by notification in the official gazette, specify in this behalf. The CII for different years is given in the following table:

#### **REVISED COST INFLATION INDEX**

Financial Year	Index
2001-02	100
2002-03	105
2003-04	109
2004-05	113
2005-06	117
2006-07	122
2007-08	129
2008-09	137
2009-10	148
2010-11	167
2011-12	184
2012-13	200
2013-14	220
2014-15	240
2015-16	254
2016-17	264
2017-18	272
2018-19	280

### **Exceptions:**

Indexation benefit is not available in respect of the following:

1. Short term capital assets;
2. Bonds / debentures other than Capital Indexed Bonds Issued by Government;
3. Shares/Debentures of Indian Company Purchased in Convertible Forex by non-residents;
4. Depreciable assets;
5. Units purchased in foreign currency u/s 115AB by an Offshore Fund;



6. GDRs purchased in foreign currency u/s 115AC by Non-Residents;
7. Securities u/s 115AD purchased by non-residents;
8. Where option of 15% tax rate is claimed/s 112 in respect of capital gain on shares;
9. Slump Sale u/s 50B; and
10. Foreign exchange assets u/s 115-O by Non- Resident Indians.

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## 14. EXEMPTIONS – SECTION 54

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Sections 54, 54B, 54D, 54EC, 54F, 54G and 54H grant exemption to capital gains arising from the transfer of certain capital assets under certain circumstances. However, the syllabus covers only the exemption u/s 54. The provisions of the section are dealt with below.

### Profit on sale of property used for residence Section 54

A. **Eligible assessee** : Individual or HUF.

B. **Eligible capital gain** :

- in respect of capital gain arising on transfer of a **long term residential house used for self-occupation or let out**, the income of which is chargeable under the head, 'Income from house property' ;
- short term capital gain will not be eligible for exemption

C. **Eligible investment**:

- The assessee or in case of his death, his legal representative has
  - i) purchased **one residential house** in India within
    - a. a period of one year before such transfer or
    - b. a period of two years after such transfer, or
  - ii) constructed one **residential house** in India within **three years after such transfer**.

D. **Other points**

- (i) Old house must be a residential house (In India or outside India, chargeable under the head income from house property whether for own residence or for letting out.
- (ii) The new house also must be a residential house and must be situated India.
- (iii) the new house may be purchased before or after, but construction should be only after the sale of old house.

E. **Extent of exemption**

The exemption will be to the extent amount invested in the purchase or construction of the second house.

### Illustration

On 01-01-2010 Ashok purchased a residential house for self-occupation for Rs 5 lakh and spent Rs 1 lakh on its registration and improvement. He sold the house on 01-01-2018 for Rs 19 lakhs and purchased a new residential house on 01-04-2017 for Rs 6 lakh. The exemption u/s 54 will be as under :-

Particulars	Rs
Sales consideration	19,00,000
Indexed cost of acquisition + improvement Rs. ( 5,00,000+1,00,000) *272/148 Revises index for F.Y. 2009-10 & 2017-18.	11,02,703
LTCG	7,97,297
Exemption u/s 54	6,00,000
Taxable capital gain	1,97,297

#### F. Restriction of transfer of new house

If the new house is transferred within a period of three years from the date of its purchase or construction, the amount exempt u/s 54 will be reduced from cost of the new house and the capital gain will be accordingly computed.

#### G. Deposit Account

Unutilised amount of the capital gain for purchase or construction of a new house is required to be deposited in a specified deposit account with a bank before the date for furnishing the return of income and the proof of such deposit is required to be filed with the return of income. Amount so deposited will be treated as amount utilized towards acquisition of new house.

The amount in deposit account can be utilised for purchase or construction of house within the specified period.

The unutilised amount is treated as capital gain of the relevant previous year in which the period of three years from the date of transfer of the old house expires

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### 13. ILLUSTRATIONS

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1. State whether the following are the capital Asset or not:

- (a) Bicycle
- (b) Horse
- (c) Car
- (d) House for self residence
- (e) Jewellery
- (f) House let out
- (g) Silver ornaments

- (h) Air Conditioner used as stock in trade
- (i) Air Conditioner not used as stock in trade
- (j) Rural Agricultural Land
- (k) Urban Agricultural Land

**Solution:**

Items (d) House for self-residence, (e) - Jewellery, (f) -House let out , (g) - Silver ornaments and (k) -Urban agricultural land are capital assets .

Items (a) - Bicycle, (b) horse, (c) personal car, (i) personal air conditioner are personal effects, hence not capital assets.

Items (h) Air-conditioner used as stock in trade and – (j) -Rural agricultural land are excluded from the definition of capital asset.

**2.** State whether the following transactions are transfer :

1. A house transferred by way of will to son.
2. Bonus shares given by a company to its shareholders.
3. Giving away jewellery for a piece of land.
4. Getting money in lieu of shop in a shopping complex.
5. Giving the rights to use the asset.

**Solution**

- 1) Transfer by will is not transfer
- 2) Issue of bonus share is not transfer
- 3) Exchange of jewellery with land is transfer of both assets.
- 4) Money being consideration of shop, it is transfer.
- 5) Not transfer as asset only hired

**3.** An asset was acquired on 31 May 2001 for Rs 20,000, it was substantially improved on 30 June 2004 for Rs 5,000 and sold on 10 December, 2017 for Rs 75,000. Compute the capital gains.

**Solution:**

Particulars		Rs
Sales consideration		75,000
Indexed cost of acquisition (20,000* 272/100)	54,400	
Indexed cost of improvement 5,000 X 272/113).	<u>12,035</u>	<u>66,435</u>
Long Term Capital Gain		8,565

**4.** Assume that the asset was acquired before 01-04-2001 & and improvement were carried before 01-04-2001 and there is no change in fair market value on 01-04-2001.

**Solution:**

Sales consideration		75,000
Indexed cost of acquisition (20,000 X 272/100) on 01-04-2001*	54,400	
Cost of improvement Ignored (Pre-01/04/2001 - *Optional)	<u>0</u>	54,400
Long Term Capital Profit		20,600

5. A sells a residential house property in Mumbai for Rs. 30,00,000 on May 15, 2017. The house was purchased by him on June 11, 2002 for Rs 9,00,000. Compute the capital gain

**Solution:****Rs.**

Sales Consideration.	30,00,000
Less- Indexed cost of acquisition 9,00,000X 272 /105	23,31,413
Long Term Capital Gain	<u>6,68,587</u>

6. A sells a flat on 13 April, 2017 for Rs 8,00,000. He had acquired the flat on 15 August 2004 for Rs 1,50,000 and had incurred capital cost of major repairs of Rs 1,00,000 in 2007-08.

**Solution**

		<b>Rs.</b>
Sales Consideration		8,00,000
Indexed cost of acquisition (1,50,000*272 /113)	3,61,062	
Indexed cost of improvement (50,000* 272/ 129)	2,10,852	5,71,914
Long Term Capital Gain		3,28,086

7. X purchased a house property for Rs. 6,00,000 31/02/2016 and constructed an additional floor in March 2016 for 1,10,000. The house property was sold for Rs 8,10,000 31/03/2018. The expenses incurred on transfer of asset were Rs. 10,000. Compute the capital gains from the transaction and show the difference, if any, if the house was constructed in March, 2017

**Solution:**

Sales consideration		8,10,000
Less: Expenses For Transfer		10,000
Net Sales Consideration		8,00,000
Indexed cost of acquisition 6 lakh * 272/254	6,42,698	
Indexed cost of improvement 1,10,000 x 272/254	1,17,795	7,60,493
Long Term Capital Gain		<b>39,507</b>

**Notes:** 1. Date of purchase will be the date of acquisition.  
Construction of additional floor is improvement to the property.

2. If the house was constructed in March, 2017, it is held for 12 months, which is less than 24 months. It will be short term capital asset not entitled to indexation. Resultant capital gain of Rs. 90,000 will be Short Term Capital gain [Rs. 800000- (6,00,000+ 1,10,000 )

8. On 1/7/2017 X sold gold jewellery for Rs. 2,00,000. It was purchased on 1/7/1970 for Rs 9000. Market Value of the jewellery as on 1st April 2001 was Rs. 80,000. Compute taxable amount of capital gain, if the expense on transfer is 5% on sales price.

**Solution:**

		Rs.
Sales Consideration		2,00,000
Less: Indexed Cost of Acquisition cost as on 01/04/2001 = $9000 \times \frac{272}{100}$	1,90,400	
Expenditure on transfer (0.5% x 2,00,000)	1,000	1,91,400
Long Term Capital Gains		8,600

9. X invested Rs. 4,00,000 in ornaments and Rs. 80,000 in unquoted equity shares on 1<sup>st</sup> March 2015. He sold the jewellery for Rs. 5,00,000 and shares for Rs. 1,60,000 on 1<sup>st</sup> August 2017. He paid ½% brokerage on both the investments, both at the time of purchase and sale. Calculate the taxable amount of capital gain.

**Solution**

A- Capital Gain on sale of Ornaments

Particulars	Rs.	Rs.
Sales Consideration		5,00,000
Less: Cost of Acquisition	4,00,000	
Brokerages on purchases (0.5% x 100,000)	2,000	
Brokerages on Sales (0.5% x 5,00,000)	2,500	4,04,500
Short Term Capital Gain as ornaments held for 30 months (1/3/2015 to 1/8/2017) less than 36 months, hence STCG, no indexation.		<u>95,500</u>

B- Capital Gain on sale of Shares

Particulars	Rs.	Rs.
Sales Consideration on Sale of Shares		1,60,000
Less: Indexed Cost of Acquisition	80,000	
Brokerages on purchases (0.5% x 50,000)	400	
	80,400	
$80,400 \times \frac{272}{240}$	91,120	
Brokerages on Sales (0.5% x 1,60,000)	800	91,920
Long Term Capital Gain (No STT paid, hence exemption not available)		<u>67,080</u>

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**18. SELF ASSESSMENT QUESTIONS:**


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1. Write short note on:
  - a. Short Term Capital Gain
  - b. Cost of Acquisition
  - c. Cost of improvement
  - d. Expenditure on transfer
  - e. Transfer
2. Explain the term 'capital asset'.
3. Explain capital gains on compulsory acquisition of a capital asset.
4. What is "transfer" in relation to a capital asset?
5. State the situations under which the written down value of a "block of assets" will be reduced to nil.
6. Give any five items are not considered as 'capital asset'.
7. Explain the provisions regarding:
  - i. Conversion of capital assets to stock-in-trade.
  - ii. Capital gains in case of depreciable assets.
8. State whether the following are the capital Asset or not:
  - a. Bicycle
  - b. Horse
  - c. Car
  - d. House for self residence
  - e. Jewellery
  - f. House let on hire
  - g. Silver utensils
  - h. Air Conditioner used as stock in trade
  - i. Air Conditioner not used in own house
  - j. Rural Agricultural Land
  - k. Urban Agricultural Land

*{Ans: item g is not capital asset}*

9. Whether the following transactions are transfer in relation to capital asset.

- a. A house transferred by way of will to son.
- b. Bonus shares given by a company to its shareholders.
- c. Giving away jewellery for a piece of land.
- d. Getting money in lieu of shop in a shopping complex.
- e. Giving the rights to use the asset.

*[Ans: only c and d are transfers]*

10. Ajay converted unquoted shares (kept as investment) as his stock in June, 2015. He had purchased the shares in F.Y. 2011-12 for Rs. 2,00,000. The market value of the shares, in June 2017 Rs. 8,00,000. He sold the shares Rs. 9,20,000 on 30/10/2015. Compute taxable capital gains.

*(Ans: Rs 1.20 lakh business profit and LTCG (8 lakh -2 lakh \*254/ 182 = Rs 5,20,879 in 2015-16 , taxable in A.Y. 2018-19)*

11. Aditya sold his only house property occupied by him as residential house for Rs 18 lakh on 31/12/2017. The house

property was purchased by him on 28/02/2005 for a consideration of Rs 2 lakhs. Determine the capital gains.

(Ans: LTCG Rs 13,18,484 =  $[18,00,000 - \text{Rs. } 2,00,000 \times 272/113]$ )

12. Siddharth converts his plot of land purchased in July 2006 for Rs 60,000 into stock-in-trade on 31<sup>st</sup> March 2014. The fair market value on 31.3.2004 is Rs 1,60,000. The stock-in-trade was sold for Rs 2,00,000 in the month of January 2018. Find out the taxable income, if any, and if so under which "head" of income and for which "assessment year".

(Ans: LTCG  $1,60,000 - 60,000 \times 220/122 = \text{Rs. } 91,803$  in AY 2014-15 Business Income Rs. 40,000 taxable in AY 2018-19)

13. X acquired a plot of land on 30.6.2006 for Rs. 2,20,000. Brokerage and other incidental expenses on acquisition of plot were Rs. 30,000. X sold the plot of land on 30.6.2017 for Rs. 12,50,000. What will be the amount of capital gain? Can he claim deduction for ground rent paid by him amounting to Rs. 5,000 during the period when he held the asset?

(Ans: LTCG  $12,50,000 - 2,50,000 \times 272/122 = \text{Rs. } 7,43,622$ , No)

14. Raju Purchases 250 equity shares of ABC Ltd on 01/04/2011 @ Rs. 270 per share and incurs Rs. 500 on brokerage and transfer. On 01/07/2012, he gets 200 bonus shares. On 01/09/2014 he gets 300 right shares @ Rs 140 per share. On 28/02/ 2017 he sells all the 750 shares @ Rs 1000 per share and incurs expenditure of Rs. 1,500 on brokerage. Compute his taxable capital gain. (STT not paid)

(Ans: Sales  $[750 \times 1000] - 1500 = \text{Rs } 7,48,500$  - Purchase  $[(250 \times 270 + 500) \times 272/184] = \text{Rs } 1,00,522 + 0$  Bonus + Right  $[300 \times 140] \times 272/240 = 47600$  LTCLG Rs. 5,99,278 i.e.  $\{7,48,500 - 1,48,122 = [1,00,522 + 0 + 47,600]$

15. WDV of the block on 01/04/ 2017 of the block (depreciation 25%) comprising of two copier is Rs. 6 lakh. Both the copier were discarded on 31/03/2018 and sold for Rs. 80,000. Each. New copier was bought on 01/04/2018. For Rs 13 lakh. Compute the amount of capital gain chargeable/ Depreciation.

(Ans: STCL - 4.8 lakh 31,000 No depreciation on empty block. New copier will qualify for dep. In A.Y. 2019-20).

16. Ramesh sold jewellery on 15/11/2017 for Rs. 4,50,000. He purchased it on 01/04/2014 for Rs. 3,05,000. He paid brokerage of Rs. 4,000 for purchase and Rs. 2,000 for sale. Compute capital gains chargeable to tax.

(Ans: LTCG RS 98,800 =  $\{4,50,000 - 2000 - [3,05,000 + 4000 \times 272/240]$ )

17. Mahesh sold his flat 15/04/2017 for Rs 16.5 Lakh. He had purchased it for Rs 50,000 on 03/07/1983. Its market value as on 01/04/2001 was Rs 5 lakh. He paid brokerage of Rs. 13,000 for the sale transaction. Compute the total taxable capital gain.

(Ans: LTCG  $16,50,000 - 13,000 - \{5,00,000 \times 272/100\} = \text{Rs } 2,77,000$ )

18. A purchase 1000 share of Reliance @ Rs 1000 each. Reliance goes for right issue in the ratio of 1:1 for Rs 600. A

sells( renounces) his rights for 500 shares @ Rs 50 per share to X. Ascertain the liability for taxable capital gains, if any.

(Ans: for A-STCG 1300, For X- Cost of Acquisition of right Rs 5000)

19. A sold a residential house for Rs 55 lakhs on 31/03/2015. He had inherited the house from his father in 1990, the fair market value of which as on 1.4.2001 was Rs.10 lakhs. During the year 1992-1993, he carried out further construction and improvements, at a cost of Rs. 6 lakhs. Expenditure in connection with transfer Rs. 50,000 Compute capital gains.

(Ans: LTCG Rs 55 Lakh –50,000 - [Rs. 10 lakhs X 272/100] =+Rs27, 30,000. Improvement in 1992-93 will be ignored).

20. WDV of Block of 2 machines- (depreciation 15%) owned by AK Ltd. was Rs 9 lakh as on 01//04/2017. AK purchased a new machine for Rs 8 lakh on 30/12/2017 and sold the old machines for Rs. 10 lakh. Compute depreciation and taxable capital gains if any, for AY 2018-19. Show the difference if AK sold the machines for Rs. 8 lakh. .

(Ans: a) block Rs 9 lakh+ 8 lakh – 10 lakh = 7 lakh. Deprecation @ 15% -Rs 1,05,000 b)STCG- 1 lakh , Depreciation- Nil.





## INCOME FROM OTHER SOURCES

### (Sections 56 -59)

#### Synopsis:

1. Introduction & Objectives
2. Basis of Charge
3. Incomes specifically chargeable u/s 56
4. Other incomes chargeable u/s 56
5. Some specific incomes – gifts, dividend
6. Deductions
7. Amounts not deductible
8. Miscellaneous- Balancing charge, Method of accounting
9. Self- Assessment Questions

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#### 1. INTRODUCTION AND OBJECTIVES

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This lesson deals with the provisions of section 56 to 59 relating to “Income from other sources”, its scope, computation and the deductions allowable therefrom.

This is the last and residuary head of income. Any income not covered under any other head of income specified in section 13, is chargeable to tax under this head.

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#### 2. BASIS OF CHARGE- SECTION 56

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**2.1.** As per section 56 (1), any income, which is not chargeable to tax under any other heads of income and which is not to be excluded from the total income shall be chargeable to tax as residuary income under the head “Income from Other Sources”.

**2.2.** As per section 56(2), the following incomes are specifically chargeable to tax under the head “Income from Other Sources”:-

- i. Dividends
- ii. 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.
- iii. Any sum received by the assessee from his employee as contribution towards provident fund, superannuation fund or

Employee State Insurance fund or any other employees' welfare fund, if not chargeable under the head 'profits and gains of business or profession'.

- iv. Interest on securities, if not chargeable under the head 'profits and gains of business or profession'.
- v. Rental income from machinery, plant or furniture belonging to the assessee and let on hire if not chargeable under the head 'profits and gains of business or profession.'
- vi. Composite rental income from letting machinery, plant or furniture with buildings and letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, if not chargeable under the head 'profits and gains of business or profession'.
- vii. Any sum including bonus received under keyman insurance policy, if not taxable as salary or 'profits and gains of business or profession'.
- viii. Any sums of money exceeding Rs. 50,000 in aggregate received without consideration by an individual or HUF.
- ix. Fair market value of movable property received without consideration by an individual or HUF if it exceeds Rs 50,000 in aggregate.
- x. The difference between the aggregate fair market value and the consideration received by an individual or HUF in respect of a movable property or immovable property, if such difference exceeds Rs. 50,000.
- xi. The stamp duty value of any immovable property (whether assessed or assessable) if it exceeds by Rs. 50,000 than the consideration for such immovable property received by an individual or HUF.
- xii. Shares of closely held companies having aggregate fair market value exceeding Rs. 50,000 received by a firm or a closely held company without consideration or for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs 50,000.
- xiii. Interest received on compensation or on enhanced compensation referred to in section 145A (b).
- xiv. Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if such sum is forfeited and the negotiations do not result in transfer of such capital asset.

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### 3. INCOMES SPECIFICALLY CHARGEABLE -S. 56(2)

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In addition to the residuary income chargeable to tax but not covered under other heads of income, the head “income from other sources” also covers some well-defined income given as under:-

- i. Dividend received from any entity other than a domestic company; The dividend received from a domestic company is exempt under section 10(34), because dividend is taxable in the hands of the company at the time of distribution and 18% dividend distribution tax is levied u/s 115(0). Dividend received from a cooperative bank or a foreign company, and dividend received by individual and HUF assesseees in excess of Rs 10 lakh (gross without any deduction for expenses) will be chargeable under this head.
- ii. Pension received by the legal heirs of an employee; Pension received by the employee himself during his lifetime is charged under section 17(3) as the income from salaries;
- iii. Any winnings from lotteries, crosswords, puzzles, races including horse races, card games or other games of any sort or gambling or betting of any form or nature;
- iv. Income from letting out any plant, machinery or furniture on hire where it is not the business of the assessee to do so;
- v. Interest on securities if it is not chargeable as the profit and gains of business or profession;
- vi. Employees' contribution to any staff welfare scheme received by the employer, which is not paid within the prescribed time. However deduction will be allowed in respect of the amount of contribution paid, only the balance amount will be taxable;
- vii. Income from sub-letting;
- viii. Interest on bank deposits and loans and securities;
- ix. Royalty;
- x. Directors' fees;
- xi. Casual income;
- xii. Agricultural income when taxable e.g. land situated in a foreign country,
- xiii. Income from undisclosed sources;
- xiv. Rent of plot of land;
- xv. Mining rent and royalty;
- xvi. Casual income under a will, contract, trust deed;

- xvii. Salary payable to a member of parliament;
- xviii. Gratuity received by a director who is not an employee of a company; and
- xix. Any other receipt, which is income but does not fall under the other four heads of income viz. salary or business income or income from house property or capital gain.

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## **4. SPECIFIC INCOMES COVERED**

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### **5.1. Dividend - Sec 56(2) (i)**

Dividend is the amount of profits distributed by a company among its shareholders or members. Some important principles concerning the dividend are given as under: -

1. Taxable amount of dividend shall be chargeable as income from other sources.
2. It is not relevant whether dividend is, in cash or kind or out of taxable profits or tax -free income, out of revenue profits or capital gains.
3. Dividend may be final , Interim or deemed dividend
4. Dividend declared at the at the annual general meeting of a company (AGM) , where the final accounts for the financial year are laid before the members, is called as the final dividend. Such dividend is chargeable to tax on the date of AGM, in which it is declared. Date of actual payment is not relevant. Final dividend, once declared becomes a debt due and cannot be withdrawn. In case of non-payment it is earmarked in a separate account as per the Companies Act, 2013.
5. The dividend declared by the board of directors between two AGMs is called Interim dividend. Interim dividend is taxable when it is made available or paid to the shareholders.
6. Deemed dividend is not dividend in real terms. Certain payments made to shareholders by the company or its liquidator are deemed to be dividend in the hands of the shareholder in different circumstances prescribed in Section 2(22) and are chargeable under the head income from other sources when such sums are actually paid .
7. Dividend received from a domestic company shall be exempt from tax under Section 10(34) if it is chargeable to dividend distribution tax under Section 115-O.

8. As per section 115BBDA, in the case of resident individual/HUF/firm, dividend shall be chargeable to tax at the rate of 10% if aggregate amount of gross dividend received during the year exceeds Rs. 10,00,000

**5.2. Deemed dividend: -Loan to shareholders- S. 2(22) (e)**

Under Section 2(22) (e) any sum paid as loan or advance by a closely held company

- to a shareholder for his individual benefit, and if such shareholders and his relatives holds substantial interest (10 per cent stake in share capital or voting power )in the company or
- to a concern(HUF/Firm etc) where the person having substantial interest has at least 20 per cent interest, shall be deemed to be the dividend in the hands of the shareholder.

This provision intends to prevent persons having substantial control and influence over the affairs of a company to take away all funds of the company as low-interest loans for their personal benefit to the prejudice of the other shareholders.

Some other important points are relevant: -

1. Dividend income will be taxable in the hands of the recipient in the year in which such loan or advance was given- Sec 8.
2. The section will apply only on cash loans or advances.
3. Advances made in kind e.g. Of sale of goods on credit in the normal course of business will not be deemed to dividend.
4. Dividend will be chargeable even if the loan or advance has been repaid. The courts have repeatedly held that there is no inequity in this;
5. A shareholder is entitled to set off the deemed dividend if and when company declares any dividend. In practice, since the dividend is tax-free in the hands of the shareholder, the set –off provision does not grant any real benefit of set-off to the shareholder;
6. The loan will be taxable as dividend only to the extent of free reserves of the company;
7. Loans or advance made by the lending company for which lending is the main or substantial part of its business will also not be covered by this section;
8. Any advance or loan made to a shareholder or the concern by a company in the ordinary course of its business, for purchase

of its own shares or on demerger etc will also be not be covered under this section;

9. The dividend will also be subject to dividend distribution tax @30%.
10. Substantial interest may be existing at any time during the year;
11. Any deemed dividends u/s 2(22) (e) or dividend from any other entity is, however taxable in the hands of the recipient; and.
12. Deduction of expenses on collection and interest on loan, taken for investment in shares, is available against dividend income.

### Illustrations

Ascertain the amount of deemed dividend u/s 2(22) (e) in the following situations. The companies are closely held, and the shareholder has substantial interest therein.

1. A borrows Rs. one Cr from ABC Private Ltd. and returns the loan next day, when he makes his own arrangement for finance. The Company was had free reserves of Rs 10 lakh.

### Solution

Out of the loan amount of Rs one Cr. , only Rs. 10 lakhs , to the extent of free reserve of A Ltd. will be treated as deemed dividend u/s 2(22)(e). Repayment of loan does not affect the tax liability. A is entitled to setoff dividend against dividend If and when declared.

2. A takes a loan of Rs 50 lakhs from B Ltd., having free reserves of Rs 50 lakhs.

### Solution:

Entire loan amount of Rs 50 lakhs will be deemed dividend in the hands of B U/s 2(22) (e)

3. In the above case, assume the company is a loss making company having no free reserves

### Solution

Since the company has no free reserves, the loan taken will not be taxable in the hands of A as dividend.

4. A takes a temporary loan of Rs 10 lakhs from Dee Private Limited for one month only. Thereafter, he transfers the shares. The Company was having free reserves of Rs 20 lakhs.

### Solution

Entire loan amount of Rs 10 lakhs will be deemed dividend in the hands of B u/s 2(22) (e), even if A holds substantial interest only for a part of the year.

### 5.3. Deemed dividend – Distribution by Companies: S. 2(22)

Any distribution by a company to its shareholders which entails the assets of the company, or distribution made on liquidation or reduction of capital is regarded as dividend to the extent of accumulated profits of the company.

Similarly, any distribution by a company to its preference shareholder or debentureholders is also regarded as deemed dividend to the extent of accumulated profits of the company. Dividend in this class is directly taxable in the hands of the company.

### 5.4. Interest on securities

Interest received from debentures of company, mutual funds, and government securities is taxable as income from other sources except when such income is exempt U/s 10 or is taxed as business income. If any tax is deducted at source from interest on such securities, it should be added back and only the gross income should be considered. However, in case of tax-free govt. securities, grossing up is not required as there is no deduction or TDS. However, grossing up is required in case of taxable securities and non-government securities.

From the Interest income from this head, reasonable bank charges and other collection charges, office and other expenses if the same were incurred for earning the income and interest payable on loans taken for acquiring securities can be deducted.

#### Illustration

A received Rs 45,000 as interest net of TDS @ 10% on debentures of B Ltd worth Rs 2,50,000 held by him. Calculate the interest income and the amount of TDS @ 10% that can be claimed.

#### Solution:

Dividend received net of 10% TDs:	Rs 45,000
Gross Dividend – $45000/90\%$ :	Rs 50,000
TDS claim 10 % of Gross dividend	Rs 5,000

### 5.5. Winning from Lotteries, Crossword puzzles, etc

Winnings from, Lottery, crossword puzzles, card games or other games including any game show like KBC and horse races, betting, gambling etc are all treated as income from other sources and taxed at the maximum marginal rate u/s 115BB on the gross income without considering -:

- Claiming basic exemption limit
- Deductions under chapter VI-A.
- Expenditure including collection charges, etc or allowances;
- Benefit of set off and carry forward of losses.

**Illustration**

If A wins Rs 10 lakh in a TV show, it will be subject to maximum marginal rate 30%, + 3% education cess and the secondary and higher education cess (total 30.9%) payable at source. Hence, A will receive only Rs 6,91,000 and tax will be deducted at source Rs 3,09,000

**5.6. Family Pension**

Family pension means a regular monthly payment made to the legal heirs of the employee after his death. This is treated as income from other source and not salary because there is no employer-employee relationship between the legal heirs and the employer.

Standard deduction equal to  $1/3^{\text{rd}}$  of the pension or Rs. 15,000 is available as deduction from this income. Significantly, pension amount received during the lifetime of employee is taxable as salaries u/s 17(3) and not entitled to standard deduction.

**Illustration**

Mrs. S receives Rs 60,000 as yearly pension after the death of her husband. She spends Rs. 1000 as expenses for collection of pension.

**Solution**

Pension amount	Rs 60,000
Less: Lower of the following :	Rs 15,000
• $1/3^{\text{rd}}$ of the pension i.e. =	
Rs 60,000 X $1/3$ = Rs 20,000 or	
• Rs 15,000	
Taxable Pension	Rs 45,000

*No further deduction will be allowed in respect of collection expenses.*

**5. 7. Gifts in the hands of individuals and HUFs:**

Traditionally the gifts were not taxable being capital receipts. Later, section 56 has been amended to bring gifts under the tax net. Provisions regarding the taxability of gifts are summarised below.

**5.7.1 Taxable Gifts**

As per U/s 56(2) ((vii), following receipts by an individual or a Hindu undivided family, in any previous year from any person or persons will be taxable as "Income from Other Sources":

- a. The whole of the aggregate value of any sum of money, received without consideration, the aggregate value of which Rs. 50,000.
- b. Any immovable property,



- i. without consideration, the stamp duty value of which Rs 50,000 , the stamp duty value of such property;
- ii. for a consideration which is less than the stamp duty value of the property by an amount exceeding Rs 50,000,

Following points are important in this regard :

#### **5.7.2 Date of valuation**

When the date of agreement and the date of registration are not the same stamp duty value will be considered on :-

- the date of agreement if any part or whole of the amount of consideration thereof, has been paid by any mode other than cash on or before the date of the agreement;
- the date of registration in all other cases .

#### **5.7.3 Disputed Value**

If the stamp duty value of immovable property is disputed by the assessee u/s 50C (2), the Assessing Officer may refer the valuation of such property to a Valuation Officer as per the provisions of Sec 50C and 155(15) will apply for valuation of capital asset.

#### **5.7.4 Any property, other than immovable property-**

- without consideration, the aggregate fair market value of which exceeds Rs. 50,000, the whole of the aggregate fair market value of such property; or
- for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs 50,000, the aggregate fair market value of such property as exceeds such consideration.

#### **5.7.5 Exceptions:**

The provisions will not apply to any sum of money or property received- :

- (a) from any relative; or
- (b) on the occasion of the marriage of the individual; or
- (c) under a will or by way of inheritance; or
- (d) in contemplation of death of the payer or donor; or
- (e) from any local authority defined in S 10[20]-Explanation
- (f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in S. 10 (23C) ; or
- (g) from any trust or institution registered u/s 12AA

#### **5.7.3 Meaning of Property:**

Property” means the following capital asset of the assessee: —

- a. immovable property being land or building or both;
- b. shares and securities;

- c. jewellery;
- d. archaeological collections;
- e. drawings;
- f. paintings;
- g. sculptures;
- h. any work of art; or
- i. Bullion

#### 5.7.4 Meaning of Relative

Relative “means:

- I. In relation to an Individual :
  - a. spouse of the individual;
  - b. brother or sister of the individual.
  - c. brother or sister of the spouse of the individual ;
  - d. brother or sister of the either of the parents of the individual,
  - e. any lineal ascendant or descendant of the individual
  - f. any lineal ascendant or descendant of the spouse of the individual
  - g. spouse of the persons referred to in (2) to (6) above.
- II. In relation a Hindu Undivided Family any member thereof.

#### 5.7.5. Cost of Acquisition

While computing capital gains, cost of acquisition of a property received by a transferor from any exempted mode of transfer e.g. will, is taken at the same cost as that of the previous owner. Further, cost of acquisition of a property received without consideration and is chargeable u/s 56 when it is subsequently sold or transferred shall be the value considered u/s 56.

#### Illustration

A painting valued at Rs 10 lakh is transferred for Rs 8 lakh. Difference of between the consideration and the fair market value of Rs 2 lakh, will be charged u/s 56 being value of inadequate consideration. The painting is resold for Rs 15 lakh, the capital gain will be computed by taking the cost of acquisition of Rs 10 lakh i.e. Rs 15 lakh – 10 lakh = Rs. 5 lakh .

#### 5.8. Issue of shares at premium

Aggregate consideration received by a closely held company (private company), which issues shares at premium or above their face value during a previous year to any person being a resident, to the extent such consideration exceeds the fair market value of the shares by Rs 50,000 except when the shares are issued

- to a venture capital company or
- other company notified by the Central government.

Fair market value of the shares will be determined as per the prescribed rules, vi., net asset value or break-up value method or any other method as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets, being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature

### Illustration

A company issues 10,000 shares @ Rs. 200 as against the fair market value of Rs. 100 per share. Then  $10000 \times (200-100) = \text{Rs } 10 \text{ lakh}$  will be treated as "income from other sources, unless the company is a venture fund or other notified company.

Following table summarizes the position of gifts u/s56

<b>TAXABLE GIFTS AT A GLANCE</b>		
<b>INDIVIDUALS AND HUFs</b>		
<b>RECEIPTS WITHOUT CONSIDERATION</b>		
<b>Cash</b>	50,001	Aggregate
<b>Movable Assets</b>	50,001	Aggregate
<b>Immovable Assets</b>	50,001	Per Property
<b>INADEQUATE CONSIDERATION [ FMV- CONSIDERATION]</b>		
<b>Movable Assets</b>	50,001	Aggregate
<b>Immovable Assets</b>	50,001	Per Property
<b>Shares Of Pvt Co.</b>	50,001	Consideration or
<b>Recd by firm or Co</b>		difference with FMV
<b>Sh. Premium by Pvt Co</b>	50,001	Difference with FMV

### Illustration

Compute the total income of XYZ, who receives Rs 60,000 in cash and of 500 shares of a company valued at Rs. 120 per share as gift from each of the following persons:

1. B, his neighbour.
2. C, employer
3. D, one of his patients
4. E, his sister on the occasion of his daughter's marriage.
5. F, in contemplation of death.
6. Mrs. A
7. Mr. husband of E
8. H, son of E
9. X, a stranger on his marriage.

**Solution****COMPUTATION OF TOTAL INCOME OF XYZ**

Particulars	Rupees
Salaries -gift from employer C U/s 17	1,20,000
Profits and gains of business & profession- Gift from patient -D u/s 28	1,20,000
Income from Other sources- Sec 56 sister E 's son [ nephew not exempted] B- his neighbour 1,20,00X2	2,40,000
Total income	3,00,000

- Gift of shares of Rs640,000 and cash Rs 60,000 each treated at par. Therefore, total gift in each case Rs 1,20,000
- Exempt gifts from – ( with reason in brief )  
E - sister – Relative  
F in contemplation of death ( *Gift mortis Causa* ).  
Mrs. A- spouse –Relative  
G -E's husband – Sister's spouse –Relative  
On Occasion of marriage (Relationship not relevant )

**5.9 Gifts Received by firms and companies**

When a firm or a closely held company receives, in any previous year, from any person or persons, any shares of another closely held company-

- Without consideration and the aggregate fair value of such shares exceeds Rs 50,000, the whole of the aggregate fair market value of such shares or property;
- for a consideration which is less than the aggregate fair market value of the shares by an amount exceeding Rs 50,000, the aggregate fair market value of such property as exceeds such consideration .

This section will not how ever apply to transactions not regarded as transfer u/s 47.

**5.10.** Under the new sub-section 56(2)(vii), firms, widely held companies and AOP are liable to pay tax on the difference between fair market value and the actual consideration of movable or immovable asset.

**Illustration-11:**

A Pvt. Ltd. buys shares in B Ltd of Rs 15 lakh for Rs 8 lakh from C. the difference in the consideration and the fair market value amounting to Rs 7 lakh will be taxable u/s 56.

**Important Points:**

- i. Limit of Rs 50,000 is for each category in case of cash and movable assets and cash but Rs. 50,000 is per immovable property as the section says "such property"
- ii. Rs. 50,000 is not the basic limit. Once the limit of Rs 50,000 exceeds, entire sum will be taxable. For instance, A receives cash gift of Rs. 40,000 it will be exempt as it is below Rs 50,000 if he receives another gift of Rs. 10,100 from C. The aggregate gifts of Rs. 50,100 will be taxable without any basic exemption.
- iii. The list of relatives does not include nephews/nieces/ cousins.
- iv. List of relatives includes Spouses, Siblings - own, spouses' and parents, lineal ascendants and descendants and spouses.
- v. List of relatives includes uncles and aunts of the individual but not those of the spouse.
- vi. Stamp duty valuation will have same meaning as in S 50C.
- vii. Fair Market Value can be determined by the valuer.
- viii. Business assets like stock are not covered by these provisions and normal sale or purchase transactions will not attract the provisions of this section.
- ix. Any movable property like shares, securities, jewellery, drawings, paintings, sculptures, work of art or archaeological collections or immovable , without consideration, having aggregate fair market value exceeding Rs 50,000 during a previous year, for a consideration falling short of their aggregate fair market value by more than Rs 50,000 will be covered by this provision.
- x. Partition in HUF, transaction between relatives and trusts are still excluded from the scope of the section.
- xi. Shares received by an individual or HUF as a consequence of demerger or amalgamation of a company or a business reorganisation of a co-operative bank shall not to be subject to tax by virtue of section 56(2)(vii).
- xii. The section has been enlarged to include firms and companies in its purview.

**5.10. Additional compensation**

Income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A.

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## **6. DEDUCTIONS -SECTION 57**

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Section 57 allows the following deductions in computing the income from other sources:

### **I In case of taxable dividend income and interest from securities:**

Any reasonable sum paid by way of remuneration or commission for the purpose of realising such income including interest on borrowed capital if such borrowed capital is used for making investment in shares or securities.

### **II In case of income from plant, machinery or furniture given out on hire:**

- a. Current repairs to building.
- b. Current repairs to machinery, plant or furniture.
- c. Insurance premium paid for insuring the plant, machinery, building or furniture.
- d. Depreciation on building, machinery, plant or furniture.
- e. Any expenditure (not being capital expenditure or personal expenditure) which has been incurred wholly, necessarily and exclusively for earning income, such expenditure will also be allowed as a deduction, e.g. sub-letting expenses. Office stationery, rent, salaries, etc where maintenance of office is necessary for earning the income.

### **III In case of family pension received by legal heirs of an employee,**

A standard deduction of 1/3rd of such amount received as family pension or Rs. 15,000, whichever is less.

For this purpose, family pension means a regular monthly payment made to the legal heirs of the employee after his death. Significantly, pension amount received during the lifetime of employee is taxable as salaries and not entitled to standard deduction.

- IV. Employees' contribution to Provident or any other fund if deposited before the due date.
- V. Any allowances paid for breeding or maintaining the racehorses.
- VI. A deduction of 50% against the enhanced compensation received and no further deduction will be allowed from the income.

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## 7. AMOUNTS NOT DEDUCTIBLE- S. 58

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The following amounts are not deductible while computing income under the head “income from other source”:-

- a) Personal expenses of the assessee;
- b) Any interest which payable outside India, on which income tax has not been paid or deducted at source;
- c) Any sum paid on account of wealth tax in India or abroad;
- d) Any amount not allowable by virtue of it being unreasonable;
- e) In case of foreign companies, expenditure in respect of royalties and technical services received under an agreement made after 31/3/76; and
- f) Any expenditure in connection with income from winning from lotteries, crosswords, puzzles, races including racehorses, car races and other games of races, gambling, betting of any form. However, expenses are allowed as a deduction in computing the income of an assessee who earns income from maintaining as well as holding racehorses.

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## 8. MISCELLANEOUS

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### a) **Balancing charge taxable-S. 59**

Any amount received, or benefit derived in respect of any expenditure, incurred or loss or trading liability allowed shall be deemed to be the income of the year in which such benefits is accrued or received as the case may be.

### b) **Method of accounting- S. 145**

Section 145 relating to method of accounting is also applicable to the computation of income from other sources. Income under this head is computed in accordance with the method of accounting regularly employed by the assessee i.e. if the assessee accounts only on cash receipt and cash payment basis, income will be treated on cash payment and cash receipt basis only; otherwise it will be treated on mercantile basis. An assessee can adopt either the cash method or accrual method of accounting. Hybrid method is not permissible. However, certain items like lottery, horse races, dividend u/s 2(22)(e) can only be recorded on cash basis because of their variable nature.

### c) **Grossing Up:**

Many times, dividends, interest from securities are received after TDS. In such case amount to be included in total income is gross amount and not the amount received. Amount of TDS should be added back.

**Illustration**

A receives taxable interest of Rs. 81,000 after deduction of 10% TDS. Find out the taxable income.

**Solution**

Amounts to be taxed will be gross amount Rs. 90,000 i.e.

$$\frac{\text{Rs } 81,000 \times 100}{(100-10)}$$

*Rupees 90,000 will be included in the income and credit for TDS of Rs. 9,000 will be claimed against the tax payable.*

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**9. SELF-EXAMINATION QUESTIONS:**


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- 1) Enumerate any five items of income, which are included under the head 'income from other sources'.
- 2) Define Dividend. Discuss the taxability of dividend.
- 3) What are the incomes included under the subhead of winning? What is the rate of tax on such incomes?
- 4) What are the deductions allowable in respect of hire charges of plant and machinery?
- 5) Are there any amounts, which are not allowed as deductions while computing the income from other sources? Give examples.
- 6) A is in receipt of pension as a retired government employee @ Rs. 10000 per month. Besides, he is in receipt of family pension of his late wife @ Rs. 6000 per month. Show how the two amounts will be treated for tax purposes.

(Own pension salary / wife's pension other sources with std deduction Rs 15000)

- 7) Show the head of income under which the following items would be charged.
  - a. Rent received by an event manager on letting out tents /pandal.
  - b. Hiring charges received by a taxi driver.
  - c. Car hiring charges received by a company from the cars requisitioned by the Election Commission
  - d. Interest on Income Tax Refund
  - e. Rent received by letting out own house and



- f. Rent received by sub-leasing premises.
- g. Computer hiring charges.
- h. Salary of director
- i. Salary of M.P/ MLA
- j. Rent of a house.
- k. Rent of a plot of land.
- l. Rent of a machine let on hire along with building and letting is separable.
- m. Dividend from domestic company.
- n. Winning from TV game show like.

(Hints/Answers: item e/j remaining other sources. Director if employee, then salary)



## EXCLUSIONS AND DEDUCTIONS

### S 80C, 80CCC, 80D, 80DD, 80E, 80 U

#### Synopsis:

1. Introduction and Objectives
2. Exemptions and deductions
3. Income exempt under section 10
  - a. Agricultural income-S-10(1)
  - b. Receipts by a member from a Hindu Undivided Family-S 10(2)
  - c. Share of profit of a partner in a firm –S-10( 2A)
  - d. Income of minor Child –S.10(32)
  - e. Dividend Income –domestic companies-S-10(34)
  - f. Dividend Income- Mutual fund units- S-10(35)
  - g. Other Exemptions
4. Deductions –S.80 –Chapter VIA
  - a. Investments –S80C
  - b. Pension Plan –S 80CCF
  - c. Mediclaim -80D,
  - d. Physical Disability -80DD,
  - e. Treatment f major diseases -80DDB,
  - f. Interest on educational Loans 80E,
  - g. Physical Disability(Own)-80U:
5. Solved Examples
6. Self-Assessment questions

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### 1. INTRODUCTION & OBJECTIVES

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This lesson deals with the provisions of Income Tax Act 1961 relating to exemptions and deductions. Exemptions mean exclusion of income from the total income. Deductions are allowed after considering the income in computation. For computing the total income in accordance with section 80 of chapter VIA of the Act. Deduction may be in respect of some income and also in respect of some expenses.

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### 2. EXCLUSIONS VS DEDUCTIONS

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#### 2.1. Exclusions:

Income, which is not chargeable to income tax, is called exempt income. Hence, such incomes are excluded from the computation of total income and do not form part of total income

Every income is chargeable to income tax unless it is specifically exempt and the person, who claims an income to be exempt, has to prove that such receipt is so exempt.

Exemptions are granted to a person or class of persons e.g., charitable trusts in respect all or some of their incomes. On the other hand, some incomes are e.g., agricultural income exempt in the hands of all types of assesseees. Further, exemptions may be unconditional or subject to fulfillment of certain condition such as in case of startups, SEZ etc.

Sections 10 to 13 deal exclusively with incomes , which are exempt from income tax while sections 15 to 56 provide for certain exemptions available under a particular head while computing income under different heads viz Salaries, Income from house property, Profits and gains of business & profession, Capital gains and Income from other sources.

A receipt not falling under the definition of income u/s 2(14) or a receipt, which is of capital nature, may be claimed as exempt, unless it is specifically chargeable to income tax.

To summarize exempt incomes may be of following types:

- Income exempt u/s 10-13
- Income exempted under different heads of income S 15-56
- Income of capital nature not specifically chargeable to income tax and
- Income not falling in the definition of income.

## 2.2 Deductions

After the income has been computed under different heads of income as provided in sections 15-56, deductions are allowed under the provisions of sections 80 of chapter VIA of the Act. Hence, deductions are allowed **after** the gross total income is computed either in respect of any income or revenue or in respect of any payment or expenditure.

Sections 80IA, 80IB etc. provide for deduction in respect of revenue or income of a class of assesseees like software, infrastructure companies, companies engaged in construction of affordable housing etc. , while sections 80 C , 80D etc. provide for deductions in respect of investments in specified securities, payment of mediclaim, expense on handicapped dependent etc.

Some important exemptions and deduction are discussed below.

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### 3. INCOME EXEMPT UNDER SECTION 10:

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Section 10 provides that any income falling within any of the clauses of that section shall not be included in computing the total income of a previous year of any person. However, burden is on the assessee to prove that a particular item of income falls within this section. Syllabus includes only exemption available under a particular head. All such exemptions are taken up with the respective heads of income. Some other incomes are as under:-

#### 3.1 AGRICULTURAL INCOME – S 10(1):

Under the constitution of India, agriculture is in the state list and the central government is not constitutionally competent to levy taxes on agriculture. Accordingly, agricultural income is exempt u/s 10(1) of the Act. Rate purposes, if agricultural income exceeds Rs 5000)

#### Meaning of agricultural income

U/s 2(1A) Agricultural income” means any :-

- 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; or
  - raising the performance by a cultivator or receiver of rent-in-kind of any process to render the produce raised or received by him fit to be taken to market or
  - the sale of such produce without performing any other process as stated above. ;
- C. **any income derived from any building :**

Owned and occupied by owned and occupied by the

  - i. receiver of the rent or revenue of any such land, or
  - ii. cultivator or
  - iii. receiver of rent-in-kind, of any such land
  - iv. IF such building is
    - a) on or in the immediate vicinity of the land, and
    - b) required as a dwelling house, or storehouse, or other outbuilding by reason of its connection with the land, and the land is
      - assessed to land revenue in India or
      - subject to local rates and taxes assessed and collected by the government and
      - situated in any area within the distance measured aerially from the local limits of any municipality or cantonment board depending upon its population as per the last published census namely -

- 2 kms if population is more than 10,000 but not exceeding 1 lakh;
- 6 kms. if population is more than 1 lakh but not exceeding 10 lakh; or
- 8 kms. if population is more than 10 lakh.

### **Other Points**

1. Income from land situated in urban area is not exempt
2. Land situated in areas having population of 10,000 or less will qualify for exemption.
3. Agricultural income must be received in India.
4. Agricultural income from a foreign country is treated as non-agricultural income in India.
5. Receipts arising on transfer of agricultural land u/s 2(14) is not considered agricultural income
6. Any income arising from letting out the building for residential or business purpose other than agriculture will not be agricultural income

### **Illustration**

T employs S to carry out agriculture on his agricultural land at a remuneration based on the value of agricultural produce. S remits the sale proceeds of the agricultural produce to T after deducting his share of remuneration. Discuss the tax liability of Tukaram and S.

Income on sale of agricultural produce derived from agricultural in India is agricultural income is exempt u/s 10(1) in the hands of Tukaram.

However, S gets salary for rendering his services. Salary income is not derived from agricultural land; hence, it will be chargeable to income tax under the head "Salaries".

### **3.2 Share of Profit of a partner in a firm –Sec. 10(2A)**

In the case of a person being a partner of a firm, which is separately assessed as such, his share in the total income of the firm will be exempt from tax u/s 10(2A). Since, a firm like a HUF is assessed as a separate entity, this exemption is provided to avoid double taxation of same income first in the hands of the firm and then again in the hands of the partners.

However, any remuneration paid by the firm or any interest on capital shall not form part of the share of profit received by partner and will be taxed in the hands of the partners to the extent it was allowed as a deduction to the firm and will be taxed in the hands of the partners. But any remuneration or interest on capital in excess of the limits laid down in section 40 shall be chargeable to tax in the assessment of the firm and will form the part of the income allocated to partners exempt u/s 10(2A).

### 3.3 Income of minor child-S10(32):

Under 64(1A), income of a minor child is clubbed in the hands of his parent, who is having higher income except income earned by minor's personal efforts or skill. Section 10(32) provides for an exemption of the amount included in the income of such parent subject to a maximum of Rs. 1,500 per child.

#### Illustrations

1. Income of Rs 1,000 of S, a minor son is included in the income of his father F, then amount exempt u/s 10 (32) will be Rs. 1000 equal to actual income included in the hands of parent or Rs. 1,500, whichever is less.

2. Now if the income of S is Rs 15,000, . exemption u/s 10 (32) will be restricted to Rs. 1,500 only.

If income of two minor children amounting Rs 7,500 and Rs 5,500 is clubbed with the income of the father, exemption u/s 10(32) will be of Rs 3,000 being Rs 1,500 per child.

### 3.4 Dividend from domestic companies–S 10(34)

A domestic company is liable for dividend distribution tax@ 15% u/s 115-O. Hence such dividend will be exempt under section 10(34) in the hands of the shareholder.

With effect from A.Y. 2018-19, the tax on deemed dividend covered in S 2(22)(e) is included in distribution of profit u/s 115-O with tax of 30%. Hence, such deemed dividend will also be eligible for exemption under this section.

This exemption is subject to the newly inserted section 115BBDDA, which provides that any income by way of aggregate dividend in excess of Rs. 10 lakh shall be chargeable to tax in the case of an individual, Hindu undivided family (HUF) or a firm who is resident in India, @ 10%. Of gross dividend in excess Rs. 10 lakh. No deduction in respect of any expenditure or allowance or set-off of loss shall be allowed to the assessee in computing the income by way of dividends

### 3.5 Dividend from Units of mutual funds –S 10(34)

Dividend or income received in respect of units of mutual fund or administrator of the specified undertaking; or specified company is also exempt from Income tax under section 10 (34). However, the income does not include income on transfer of such units.

### 3.6 Other Exemptions:

A brief summary of exemptions u/s 10 is given for reference as it *may have a bearing on the computation*.

## APPENDIX

### A. EXEMPTION TO FOREIGNERS/ NON RESIDENTS.

1. Interest income of non-resident (persons of Indian origin) from notified securities, saving certificates/ NRE Account. Purchased in convertible foreign exchange—Sec 10(4).
2. Remuneration / salary of
  - a) Foreign diplomats -Sec 10(6).
  - b) a trainee of a foreign government-Sec 10(6)(xi),
  - c) a foreign national as an employee of foreign Enterprise I – Sec 10(6)(vi)
  - d) Non-Resident Employee of a Foreign Ship—Sec 10(6)(viii)
  - e) Person from a foreign government under Co-operative Technical Assistance Programme/ projects Sec. 10(8)
  - f) a consultant under Grant Agreement between the International Organisation and the Government of Foreign State- Sec .10(8A) :
  - g) non-resident, engaged by the agency for rendering technical services in India in connection with any technical assistance programme or project, provided in accordance with an approved agreement- S. 10(8A)
  - h) an Individual who is assigned to duties in India in connection with any Technical Assistance Programme and Project in accordance with an Agreement entered into by the Central Government and the Agency - Sec .10(8A)
  - i) an individual who is assigned to duties in India in connection with any technical assistance programme and project from a consultant referred to S 10(8A), income- S. 10(8B)
3. Income other than salary, royalty or fees for technical services from Government or an Indian concern under an approved agreement and if their tax liability is paid by the employer the tax so paid is exempt from tax. - Sec 10(6B)
4. Income accruing or arising outside India by any family member of persons covered u/s 10 (8),(8A) or (8B) , in respect of which such member is required to pay any income tax or social security tax to the Government of that foreign state. –Sec 10(9)
5. Amount of tax actually paid by an employer, at his option, on non-monetary perquisites on behalf of an employee in the hands of the employee. Sec – 10(10CC).

## **B. EXEMPTION TO SALARIED EMPLOYEES**

Exemption granted to salaried employee have been dealt in detail in the lesson relating to salaries such as

- a) Value of any travel concession/ assistance-S.- 10(5),
- b) allowance paid by the government to a Indian citizen rendering service outside India -Sec10 (7)
- c) Death cum Retirement gratuity -Sec-10(10)
- d) Commuted pension10 (10A),
- e) Leave encashment Sec 10 (10AA)
- f) Retrenchment compensation -Sec 10(10B)
- g) Voluntary Retirement Compensation of -Sec 10(10C)
- h) Value of tax-paid perquisite -10(10CC)
- i) leave travel allowance,
- j) Payment from statutory PF -Sec10(11)
- k) Any payment from National Pension Trust or upto 40% on closure of such account -Sec 10(12A /12B)
- l) house rent allowance 10(13A),
- m) special allowances etc. 10(14). Etc.

## **C. EXEMPTIONS TO INSTITUTIONS / FUNDS :**

The income of the following institutions is exempt subject to certain conditions:

1. Local authority i.e. a panchayat, municipality, municipal committee, district board or cantonment board.- S. 10(20)
2. Approved Notified scientific and research association applying which has as its object, undertaking research in social science or statistical research, and applying its income wholly and exclusively to its objects, including profits and gains of a business carried on by an institution, which is incidental to its objects. - S. 10(21)
3. News agency set up in India which applies its income or accumulates it for application solely for collection and distribution of news and does not distribute its income in any manner to its members.- S. 10(22B)
4. Regimental Fund or non-public fund.- S. 10(23AA)
5. Approved fund for the welfare of employees.- S. 10(23AAA)
6. Pension fund (Jeevan Suraksha) set up by the Life Insurance Corporation of India or a pension fund of any other insurance company.- S. 10(23AAB)



7. Khadi and Village industries Board.- S. 10(23B)
8. Public charitable trusts , religious institutions and political trusts -Sec. 11 ,12, 13
9. European Economic Community.
10. SAARC Fund for Regional Projects.
11. ASOSAI-Secretariat
12. Insurance Regulatory and Development Authority
13. Prime Minister's Relief Fund
14. National Foundation for Communal Harmony
15. University/educational institution, hospital or medical institution 10 (22)/(22A)
16. Professional bodies. S. 10(23A)
17. Notified fund, charitable/ religious institution or trust.- Sec 10(22B)
18. Mutual fund - S. 10(22B)
19. Notified Investor Protection Fund set up by recognised Stock Exchanges
20. Credit Guarantee Fund Trust for Small Industries
21. Approved Venture Capital Fund or Venture Capital Company-10(23FB)
22. Prasad Bharati (Broadcasting Corporation of India) S.10(23BBH)
23. Swachh Bharat Kosh – S . 10(23C(iiiaa))
24. Clean Ganga Fund - S . 10(23C(iiiaaa))
25. Core Settlement Guarantee Fund set up by a recognized clearing corporation in accordance with notified regulations-S 10(23EE) to the extent of contributions from members fines and income from investments.
26. Trade Union or Association of trade Unions from house property and other sources.- S. 10(24)
27. Statutory Provident Fund under P. F. Fund Act.- S. 10(25)
28. Employees' State Insurance Fund set up under the ESI Act- S. 10(25A)
29. Members of scheduled tribes residing in specified areas. - S. 10(26)
30. Statutory Corporation, body, association or institution formed or established for promoting the interests of the members of Scheduled Castes/ Schedules Tribes or backward classes or of any two or all of them.- S. 10(26B)

31. Corporation established by the Central/ State Government for promoting the interests of a notified minority community. -S. 10(26BB)
32. Ex-Servicemen Corporation established under an Act for the welfare and economic upliftment of ex-servicemen being the citizens of India.- 10(26BBB)
33. Co-operative Society formed for promoting the interest of members of either the Scheduled Caste or Scheduled Tribes.- S. 10(27)
34. Coffee Board, Rubber Board, Tea Board, Tobacco Board, Marine Products Export Development Authority, Agricultural and Processed Food Products Export Development Authority and Spice Board.- S. 10(29A)
35. Subsidy received from the Tea Board for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea under any scheme notified by the Central Government-. S. 10(30)
36. Subsidy received from the Rubber Board, Coffee Board, Spices Board or any other Board under any scheme of replanting or replacement, etc.- S. 10(31)

Exemptions not be available to the institutions u/s 10(23C) having commercial receipts of Rs. 25,00,000 or more

#### **D. CAPITAL GAINS**

1. Any long-term capital gain arising on transfer of eligible equity shares of a company acquired on or after 1.3.2003 but before 1.3.2004 and held for 12 months or more if STT is paid except in case of a transaction undertaken in foreign currency on a recognised stock exchange located in an International Financial Services Centre even
2. Any long-term capital gains from transfer of equity shares of a company or units of an equity-oriented fund on or after 1.10.2004 and subject to Securities Transaction Tax -Sec 10(38).
3. Any capital gain arising to an individual/ HUF on compulsory acquisition of an agricultural land in urban areas (situated within the jurisdiction of a municipality or a cantonment board having population of 10,000 or more or within 8 Kms from the local limits of such municipality/ board), where the compensation/ consideration is received by the assessee on or after 1.4.2004. Provided, the land was being used for agricultural purposes by the HUF/ individual or his parent(s), during the period of 2 years immediately before acquisition.

4. Any income arising from the transfer of a US 64 subject to the condition that any loss arising on transfer of units of US.64 cannot be set off against any income in the same year in which it is incurred and the same cannot be carried forward—Sec 10(33.)

#### **E. MISCELLANEOUS**

1. Daily allowance of Members of Parliament while the parliament is in session is and Members of State Legislative Assemblies (upto Rs. 2000) - Sec 10(17)
2. Any sum received on life insurance policy (including bonus) not being the amount received on the following policies -
  - a. any sum received u/s 80DD (3) or 80DDA (3);
  - b. any sum received under a Keyman insurance policy;
  - c. any sum received under an insurance policy (issued after March 31, 2003) in respect of which the premium payable for any of the years during the term of policy, exceeds 20 per cent of the actual sum assured except in case of the death of the person and the value of any premiums agreed to be returned or of any benefit by way of bonus or otherwise, over and above the sum actually assured, which is received under the policy by any person, which shall not be taken into account for the purpose of calculating the actual capital sum assured under this clause. -Sec 10(10D),
3. Family pension received by the widow or children or nominated heirs of a member of the armed forces or paramilitary forces of the Union is not chargeable to tax from A.Y. 2005-06, if death is occurred in such circumstances given below—
  - a. acts of violence or kidnapping or attacks by terrorists or anti-social elements;
  - b. action against extremists or anti-social elements;
  - c. enemy action in the international war;
  - d. action during deployment with a peace keeping mission abroad;
  - e. border skirmishes;
  - f. laying or clearance of mines including enemy mines as also mine sweeping operations;
  - g. explosions of mines while laying operationally oriented mine-fields or lifting or negotiation mine-fields laid by the enemy or own forces in operational areas near international borders or the line of control;

h. in the aid of civil power in dealing with natural calamities and rescue operations; and

i. in the aid of civil power in quelling agitation or riots or revolts by demonstrators. - Sec 10(19),

4. Any income by way of dividend referred to in section 115-O from a domestic company or any income in respect of units of mutual fund; UTI, from the administrator units from the specified company is exempt under section 10(34)/(35),

5. Interest income arising to certain persons [Section 10(15)]:

(i) Income by way of interest, premium on redemption or other payment on notified securities, bonds, annuity certificates or other savings certificates is exempt subject to such conditions and limits.

-Interest from Post Office Savings Bank Account:

(1) Rs. 3,500 in case of an individual account.

(2) Rs. 7,000 in case of a joint account.

-Interest on deposit certificates issued under the Gold Monetization Scheme, 2015 Section

6. U/s 10AA export incomes of undertakings in SEZ are exempt on pro rata basis i.e.

Business Profit X Export Turnover

Total Turnover

7. Incomes of charitable trusts and political parties subject to the provisions of Sec 11, 12 and 13.

8. any income of a foreign company received in India in Indian currency on account of sale of crude oil to any person in India subject to approved conditions being satisfied received under a notified agreement or an arrangement with the Central Government or approved by it and the receipt of the money is the only activity carried out by the foreign company in India

9. Section 10(48A): Exemption of income accruing or arising to a foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India. if(1) such storage and sale by the foreign company is pursuant to an agreement or an arrangement entered into by the Central Government or approved by the Central Government; and (2) having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Government in this behalf.

**10.** section10(48A) If the premium payable during any previous year for a policy issued on or after 1.4.2012 exceeds 10% of the actual capital sum assured, the entire amount received under such policy shall be taxable except when the sum received on the death of a person

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## 4. DEDUCTIONS UNDER CHAPTER VI A

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**4.1** Sections 80A and 80AB of chapter VIA provide for a basic framework for deduction to be made from gross total income. Salient points of such framework are as under:-

- (a) Aggregate of total income of an assessee will be computed under different heads of income as provided in sections 15-58 before making any deduction under this chapter called the gross total income.
- (b) From the gross total income long term capital gains, short term capital gain under winnings from lottery, crossword puzzles etc. are excluded as these items are treated differently for tax purposes.
- (c) From the gross total income, deductions are allowable under sections 80C to 80U of chapter VIA .
- (d) The aggregate of all deductions under this chapter cannot exceed the amount of gross total income of the assessee
- (e) Deduction is admissible to the members of an AOP or BOI in relation to their share therein under sections 80G, 80GGA, 80GGC, 80HHA, 80HHB, 80HHC, 80HHD, 80I 80IB , 80IC, 80ID, 80IE, 80J or 80JJA.
- (f) No deduction will be allowed if any exemption is claimed and allowed to eligible assessee, enterprises, units, or undertakings under sections 10A, 10Aa, 10B, 10BA, or 35AD for that year. Further, such deduction shall not exceed the profits and gains of such undertaking or unit or enterprise or eligible business.
- (g) As per section 80A, the above deduction will be available only if the assessee makes a claim in his return of income.
- (h) Section 80B clarifies that deduction in respect of any income shall be allowed if such income is included in gross total income.
- (i) For deduction in respect of any payment, the assessee has to claims the deduction and submit gives the proof of such for any investments/ expenditure etc.
- (j) Deductions under Chapter VIA are of three types:
  - I. In respect of expenditure or investments made by the assessee - section 80C to 80G
  - II. In respect certain income -sections 80HH to 80RRB
  - III. irrespective of whether income or expenditure- Sec 80 U allowable to a handicapped person.

Some of the deductions covered by the syllabus are discussed in the following paragraphs.

#### **4.2 Deduction in respect of investments in specified saving schemes-section 80C:**

Section 80C provides for deduction in respect of investment or contribution towards specified saving schemes. The basic scheme of the section is as follows:

- (i) Only individuals and HUFs are eligible for deduction under this section. Other assesseees are not eligible for deduction u/s 80C.
- (ii) Both residents and the non-resident assessee are eligible for the deduction under the section
- (iii) The deduction is allowed in respect of the aggregate amount **paid or deposited** during the previous year by the assessee in eligible saving schemes.
- (iv) The aggregate amount paid or deposited towards these schemes is called **Gross Qualifying Amount**.
- (v) The payments/investments eligible under this section are:
  - (a) Life insurance premium paid on a policy taken or renewed by
    - An individual
      - on his own life,
      - life of the spouse or any child
      - child may be dependent or independent
    - A Hindu undivided family on the life of any member of the family

The premium including the arrears of premium should not exceed 10% of sum assured if policy is taken after 0-1-04-2013 (15% for persons with handicap u/s 80U or person suffering from serious disease u/s 80DDB on policy taken after 01-04-2014). Prior to this, the restriction was up to 20% for all assesseees.

- (b) Any sum paid under the contract of non –commutable deferred annuity plan for the purpose of securing the individual or his spouse or children to pay a deferred annuity ;
- (c) Any sum deducted from salary payable to a Government employee for the purpose of securing the individual or his spouse or children to pay a deferred annuity subject to a maximum of 20% of salary;
- (d) Contribution towards statutory provident fund;
- (e) Contribution towards 15 year Public provident fund(PPF) in the name of himself, wife or child or a family member upto a maximum of Rs 1,00,000;

- (f) Contribution towards Recognized provident fund;
- (g) Contribution towards an approved *Superannuation Fund*;
- (h) Investment in 10 / 15 years Post office cumulative term deposits( CTDS);
- (i) Subscription to notified deposit scheme e.g. NSS
- (j) Subscription to National savings certificates, VIII Issue
- (k) Contribution for participating in the Unit-linked insurance plan (**ULIP**) of Unit Trust of India;
- (l) Contribution for participating in the Unit-linked insurance plan (**ULIP**) of LIC Mutual Fund (i.e. Dhanraksha plan of LIC Mutual Fund);
- (m) Payment for notified annuity plan of LIC (i.e. Jeevan dhara, Jeevan akshay, New jeevan dhara, etc. or any other insurer;
- (n) Subscription towards notified units of mutual fund/ UTI
- (o) Contribution to notified pension fund set up by mutual fund or UTI;
- (p) Any sum paid including accrued interest as subscription to home loan account scheme of the National Housing Bank(**NHB**);
- (q) Any sum paid as tuition fees (but not donation) to any university/college/educational Institution in India for full time education for maximum 2 children;
- (r) Any subscription towards infrastructure bonds or units of Mutual Funds;
- (s) Any amount paid for the purchase or construction of a residential house property or for purchase of land;
- (t) Term deposits for a fixed period for at least 5 years with a scheduled bank under a notified scheme;
- (u) Deposit in an account under Senior citizens savings scheme, 2004;
- (v) 5- years post office time deposit account;
- (w) Subscription to notified bonds issued by NABARD;
- (x) Subscription to eligible issues of equity shares or debentures of an Indian public company or a public financial institution where the entire proceeds of the issue is wholly and exclusively for the purposes of any business specified for developing, maintaining and operating an infrastructure facility for generation or generation and distribution of power or for providing telecommunication services whether basic or cellular or for developing, developing and operating or

operating and maintaining an industrial park or a special economic zone- SEZ

**Amount of deduction allowable u/s 80C :-**

- Whole of the aggregate amount paid or deposited in the above mentioned schemes the gross qualifying amount or
- Rs 1,50,000, whichever is less.
- U/s 80CCE, maximum deduction u/s 80C, 80CCC and 80CCD cannot exceed Rs 1,50,000.

(vi) Some important points:

- Payment for house include amount paid to authorised developers or repayment of loans.
- The amount of investments need not necessarily be made out of the taxable income
- Life insurance premium paid for parents will not be allowable even if parents are dependent on the assessee.
- Life insurance premium paid for married daughter will be allowable.
- Dependence of wife or children is not necessary for claiming deduction under this section.
- Refundable premium and bonus on premium are not eligible for deduction
- Premature termination( before the period shown below) from any scheme will have the following effects:
  - In the year of termination, deduction will not be allowed ;
  - Premium earlier paid and allowed as deduction will be brought back to tax in the current year and added to the total income in the assessment year pertaining to the year of withdrawal.

Premature withdrawal/Transfer/ Termination	
Life insurance Policy	Two years for whole life policy
	One year for other policy
P/O TDS / SCSS	Five Years
Unit Linked Insurance Plan	Five Years
House property-Transfer	Five Years

**Illustrations**

1. On a whole life policy, a premium of Rs. 6,000 was paid upto last year. Current year's premium otherwise eligible for deduction u/s 80C is Rs 3,000. The policy is prematurely terminated during the financial year 2017-18.



Premium paid in financial year 2017-18 will not be eligible for deduction u/s 80C. Premium of Rs. 6000 allowed earlier will be added to the income of assessment year 2018-19.

2. Kanti makes the following payments during the financial year 2017-18. His Gross Total Income amounts to Rs. 8,00,000, Compute the deduction available under section 80C and the taxable income for the A.Y. 2018-19.

School fees of his 4 children	Rs 60,000
University fees of his wife	Rs 10,000
Life insurance for wife and kids	Rs 40,000
Life insurance for parents	Rs 15,000
Life insurance for father-in-law	Rs 40,000
NSC	Rs 60,000
Repayment of principal for house	Rs 50,000
Coaching class fees	Rs 11,030

### Solution

Gross Total Income		Rs. 8,00,000
School fees up to 2 children	Rs 35,000	
University fees of wife - Not allowed	NIL	
Life insurance for wife and kids	Rs 40,000	
Life insurance for parent Not allowed	NIL	
Life insurance for father-in-law- Not allowed	NIL	
NSC	Rs 60,000	
Repayment of principal for house	Rs 50,000	
Coaching class fee Not allowed	NIL	
Deduction u/s 80C	1,85,000 – maximum	Rs. 1,50,000
Total Income		Rs. 6,50,000

3. Anshu has a Gross Total Income of Rs 8,00,000 for the AY 2018-19. He availed of deduction in AY 2014-15 of Rs 10,000 in respect of a life insurance policy, which was prematurely terminated in P.Y. 2017-18. During the year, he paid premium of Rs 28,000 on a policy himself for Rs 1,00,000, and Rs 25,000 Insurance for wife (employed with MNC), Insurance premium due for son but unpaid Rs 7,500.

4. Compute deduction u/s 80C and the taxable income of Anshu.

**Solution**

Computation of total income		Rs
Gross Total Income		8,00,000
Add: Deduction of last year on termination of policy		10,000
Revised Gross Total Income		8,10,000
Insurance for himself (in excess of 20% of sum assured)	Rs 20,000	
Insurance for wife (dependence not relevant)	Rs. 25,000	
Insurance for son (not paid)	Nil	
Total deduction u/s 80C		45,000
Total Income		7,65,000

4. Gross Total income of Manu for AY 2018--19 is Rs 10,00,000. He pays premium of Rs 22,000 on a policy of Rs 1,00,000 on his own life, Rs 15,000 each for policies of his son and brother, both being dependent on him. Manu contributes Rs. 20,000 for unrecognized provident fund, Rs. 30,000 towards PPF, and Rs 20,000 in ULIP. He repaid housing loan to ICICI Bank Rs 80,000 with Rs 20,000 towards outstanding interest.

School fees of three his children amounts to Rs 4,000 Rs. 5,000 and Rs. 6,000 respectively.

Compute the deduction/s 80C and the taxable income of Manu.

**Solution**

Computation of total income		Rs
Gross Total Income		10,00,000
Insurance-self- over 20% of sum assured	20,000	
Insurance(son)–dependence not relevant	15,000	
Insurance for brother not allowed	Nil	
Unrecognized PF -Not allowed	Nil	
Public provident Fund	30,000	
Unit Linked insurance plan	20,000	
Housing loan –Principal	80,000	
School fee –2 children – Higher figures considered 6,000=+5,000	11,000	
Total deduction u/s 80C-maximum	1,76,000	1,50,000
Total Income		8,50,000

#### 4.3 Deduction in respect of Contribution to certain pension funds – Sec80CCC.

U/s 80CCC, deduction is allowed to Individuals in respect of amounts paid/ deposited(excluding any interest /bonus accrued/ credited o the assessee) during the previous year to effect or keep in force a contract for any annuity plan of Life Insurance Corporation of India or any other insurer for receiving pension from the fund u/s 10(23AAB).

The amount received by the assessee or his nominee a) on account of the surrender of the annuity plan whether in whole or in part, in any previous year, or (b) as pension received from the annuity plan shall be deemed to be the income of the assessee/nominee, in the year of withdrawal or when pension is received maximum deduction u/s 80C, 80CCC and 80CCD shall not exceed Rs 1,50,000. (This section is directly not covered in syllabus but has an impact on deduction u/s 80C)

#### **4.4 Payment in respect of health insurance premia- S. 80D:**

Provisions of section 80D, which provides for a deduction in respect of the health premia paid are summarized as under :--

- (a) **Eligible Assessee** : individual or a Hindu undivided family
- (b) **Nature of Deduction** : payment made towards medical insurance premia paid during the previous year

(c) **Mode of Payment** : The premium shall be paid by any mode other than cash, e.g. cheque, ECS or other electronic mode. However, payment for preventive health check-up may be made by any mode including cash.

#### **(d) Amount of Deduction In case of an individual assessee**

##### **Premium and checkup for self and family**

(i) Deduction shall be aggregate of the following payments made for **self and family**, or Rs 25,000, whichever is less

- a) the whole of the amount paid (premium) to effect or to keep in force an insurance on the health of the assessee or his family ; or
- b) any contribution made to the Central Government Health Scheme or other notified scheme (popularly called Mediclaim policy), or
- c) any payment made on account of preventive health check-up of the assessee or his family upto Rs 5,000

##### **(ii) Medical expenditure for self or family member**

The whole of the amount paid on account of medical expenditure incurred on the health of the assessee or any member of his family being **a very senior citizen** if no amount has been paid to effect or to keep in force an insurance on the health of such person or Rs 30,000, whichever is less.

Thus, an assessee may either pay the insurance premium (Rs 25,000+ 5,000 for medical checkup) or incur medical expenditure subject to a maximum limit of Rs. 30,000.

##### **(iii) Premia paid for parents**

The amount of deduction shall be aggregate of the following or Rs 25,000 whichever is less

(a) the whole of the amount paid to effect or to keep in force an insurance on the health of the parent or parents of the assessee or

(b) any payment made on account of preventive health check-up of the parent or parents of the assessee as does not exceed Rs 5,000

(iv) **Medial Expenditure for parents**

The whole of the amount paid on account of medical expenditure incurred on the health of *any parent of the assessee being very senior citizen not exceeding* in the aggregate Rs. 30,000 if no amount has been paid to effect or to keep in force an insurance on the health of such person

Maximum deduction under both the above cases will be restricted to Rs 30,000

(v) **Other points**

- 'Family' means the spouse and the dependent children of the assessee
- "senior citizen" means an individual resident in India who is of the age of *sixty years or more* at any time during the relevant previous year;
- "Very senior citizen" means an individual resident in India who is of the age of *eighty years or more* at any time during the relevant previous year.
- The parents and the spouse may not be dependent upon the assessee, but his children must be dependent for claiming the deduction
- Expenses paid for preventive health check-up have a sub limit of Rs 5,000 within the overall limit of Rs 25,000 /30,000 and such expenses may be paid in cash.
- Any medical insurance premia paid to effect or keep in force an insurance on the health of any person being a senior citizen, or a very senior citizen, the limit of Rs 25,000 ( for individual and HUF) will be enhanced to Rs 30,000
- Insurer should be notified by the IRDA or Central Government

(e) **Amount of Deduction to A Hindu undivided family :**

Where the assessee is a Hindu undivided family, amount of deduction shall be the aggregate of the following, namely:—

- (i) whole of the amount paid to effect or to keep in force an insurance on the health of any member of that Hindu undivided family as does not exceed in the aggregate Rs 25,000 ; and

(ii) the whole of the amount paid on account of medical expenditure incurred on the health of any member of the Hindu undivided family being a very senior citizen as does not exceed in the aggregate Rs 30,000 , if no amount has been paid to effect or to keep in force an insurance on the health of such person:

The aggregate deduction shall not exceed Rs 30,000 .

<b>Sec 80D – Amount of deduction available to an individual ( inclusive of preventive health check-up)</b>			
Situation	Self, Spouse & Dependent Children Rs	Parent(s) whether or not dependent Rs	Total deduction u/s 80D Rs
All below the age of 60 years	25,000	25,000	50,000
Assessee and his family less than 60 years and parents above 60 years	25,000	30,000	55,000
Assessee and his family have attained the age of 60 years and above	30,000	30,000	60,000
<b>Sec 80-D Amount of deduction available to a HUF ( inclusive of preventive health check-up)</b>			
One or more member of HUF is a senior citizen			30,000
None of the members is a senior citizen			25,000

### Illustration

Raj and his wife are not senior citizens. Raj pays mediclaim insurance of Rs 18,000 for self, Rs 20,000 for his wife, and Rs 5,000 his two independent sons. He also pays Rs 18,000 for each of his parents who are senior citizens .Calculate the amount of deduction allowable u/s 80D.

**Solution**

<b>Amount of deduction u/s 80D</b>	
Premium in respect of wife	Rs 20,000
Premium for himself	Rs. 18,000
Premium in respect of children (not dependent)	Nil
Total Rs 38,000 restricted to	Rs 25,000
Add : Premium in respect of parents (senior citizens) Rs 36,000 restricted to maximum	Rs 30,000
<b>Deduction available u/s 80D</b>	<b>Rs 55,000</b>

**4.5 Sec 80DD: Deduction in respect of expenses on maintenance and medical treatment of a dependent who is a person with disability.**

(i) **Eligible assessee:** Individual and Hindu undivided family, who is a resident of India. Other assessees not eligible.

(ii) **Eligible Payments:**

a. Expenditure incurred for medical treatment including nursing, training and rehabilitation of a dependent, being a person with disability or

b. any amount paid or deposited under a scheme framed by the or any other insurer or the administrator or the specified company (UTI) approved by the Board in this behalf for the maintenance of a dependent, being a person with disability.

(iii) **Amount of Deduction :** Rs 75,000 in all cases , Rs.1,00,000, if dependent person suffers from severe disability

So long the assessee incurs some amount of eligible expenditure, the deduction will be allowed irrespective of the amount actually spent. It is not necessary to spend full amount of Rs 75,000 or 1 lakh rupees.

(iv) **Conditions for of Deduction :**

The following conditions should be satisfied to claim deduction:

(a) Deduction is available in respect of a "dependent" person.

(b) A dependent person means:-

- Spouse, children, parents, brothers or sisters of an individual or any of them.
- a member of a Hindu undivided family.

(c) Such person must be dependent wholly or mainly on such individual or Hindu undivided family for support and maintenance.

(d) Such dependent person must not claim deduction u/s 80U while computing his total income for that assessment year;

(e) The assessee nominates either the handicapped dependent or any other person or trust to receive the payment under the scheme for the benefit of the handicapped dependent;

(f) In the event of the death of the subscriber assessee, the amount of annuity or lump-sum under the scheme is paid for the benefit of the handicapped dependent.

(g) If the handicapped dependent predeceases the subscriber assessee, then the amount so received shall form part of the total income of the subscriber assessee in the previous year in which the amount is received.

(h) The assessee must furnish a certificate from a neurologist, a pediatric neurologist, in case of children,) or a civil surgeon or Chief Medical Officer of a Government hospital in form 10IA (in case of autism, cerebral palsy or multiple disability).

(i) Where the condition of disability requires reassessment, a fresh certificate shall have to be obtained on expiry of the period mentioned in the original certificate.

#### **4.6 Deduction in respect of medical Treatment-Sec. 80DDB**

**Eligible assessee:** Individual and Hindu undivided family, who is a resident of India. Other assessee not eligible

##### **Eligible Payments:**

Amount actually paid for medical treatment of specified disease or ailment of the assessee himself or a person dependent on him or a member of HUF

##### **Amount of Deduction :**

- Amount actually paid in the previous year or
- Rs. 40,000 or
- Rs 60,000, if such person or member is a senior citizen, or
- Rs 80,000, if the person or member is a very senior citizen.

*Whichever is lower?*

##### **Other Points**

(a) *“Dependent relative” means*

- a. *an individual himself ,*
- b. *spouse, children, parents or brothers and sisters of an individual , or*
- c. *a member of the HUF, who is wholly or mainly dependent for support and maintenance on the individual or the HUF*

(b) *“senior citizen” means an individual resident in India who is of the age of 60 years or more at any time during the relevant previous year;*

(c) *"very senior citizen" means an individual resident in India who is of the age of 80 years or more at any time during the relevant previous year,*

(d) The assessee shall furnish with the return of income, a certificate in prescribed form, from a neurologist, an oncologist, a urologist, a hematologist, an immunologist or such other prescribed specialist, working in a Government hospital :

(e) Amount of deduction shall be reduced by any amount received under an insurance from an insurer, or reimbursed by an employer

#### **4.7 Deduction in respect of interest on loan taken for higher education Sec 80E**

##### **Eligible assessee:**

Any individual assessee, (whether resident or non-resident) who has taken loan from a financial institution or any approved charitable institution for pursuing higher studies of himself or his relative

##### **Amount and term of deduction:**

- Interest on such loan paid by the assessee without any limit.
- Upto a maximum period of 8 years from the year in which the payment of interest on the loan begins or till the interest is paid in full, whichever is earlier.

##### **Other Points**

- 1) "Higher education" means any course or study pursued after passing Senior Secondary Education or its equivalent from any Government recognized school, Board or university.
- 2) "Course" may be any post-SSC course whether full -time or part time any Government recognised school, Board or university.
- 3) Higher education may be for the assessee himself or any of his relatives. Relative means the spouse and children of the assessee or the student for whom such individual is the guardian.
- 4) The deduction can be claimed by the student assessee himself if the interest is paid by him or his relative (say father), if interest on the student's loan is paid by the relative.

##### **Illustrations**

1. A borrows Rs 15 lakh from SBI on 01/04/2014 for pursuing MBA. The loan is repayable in 10 equal annual instalment carrying interest @ 10%. Per annum.

A being the student himself, is eligible to get deduction/s 80E upto A.Y. 2021-22. Thereafter, for the remaining two years,



no deduction will be available. Amount of deduction in respect of interest will be as under:-

Assessment Year	Interest allowable u/s 80E
2014-15	1,50,000
2015-16	1,35,000
2016-17	1,20,000
2017-18	1,05,000
2018-19	90,000
2019-20	75,000
2020-21	60,000
2021-22	45,000

2. if father of pays the interest, he will be entitled to claim the deduction.

#### **4.8 Deduction in case of a Person with Disability – 80U**

##### **Eligible assessee**

- Individual resident of India
- with at least 40% disability
- at any time during the previous year.

##### **Amount of deduction**

- Person with minimum disability of 40%- Rs 75,000 ;
- Persons with severe disability of over 80% - Rs. 1,25,000

##### **Other Points**

- 1) The deduction u/s 80U of Rs 75,000 / 1,25,000 is of a flat amount without any requirement for spending that amount.
- 2) Mere submission of a disability certificate in the prescribed form will be enough to avail the deduction along with the return of income of the assessment year for which the deduction is claimed for the first time.
- 3) Where the condition of disability requires reassessment of its extent after a period stipulated in the medical certificate, deduction for any year falling after the expiry of such period shall be allowed only if a new certificate is obtained and furnished.
- 4) “Disability” means blindness, low vision, leprosy-cured, hearing impairment, locomotor disability, mental retardation, mental illness, autism, cerebral palsy and multiple disabilities.
- 5) “Person with disability” & “Person with severe disability” have been defined in the Persons with Disabilities (Equal Opportunities, Protection of Rights & Full Participation) Act, or the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation & Multiple Disabilities Act, 1995.

## 5. ILLUSTRATIONS

1. S presents the following data for the previous year 2017-18.
  - (a) Business income Rs. 6,50,000
  - (b) Capital Gains Rs. 2,50,000
  - (c) Payment of medical insurance premium on own life Rs.10,000
  - (d) He pays Rs. 20,000 to GIC for maintenance of his severely disabled son under an approved scheme.
  - (e) He has borrowed Rs 5,00,000 as educational loan for his younger son who pursues MBA from IIM and pays 10% interest on the loan.
  - (f) S himself his severely disabled.
  - (g) Determine the income of S for the assessment year 2018-19

**Solution:**

### Computation of Total Income of X

		Rs
Business Income		6,50,000
Capital gains		2,50,000
Gross Total Income		9,00,000
Deductions under chapter -VIA-		
80D :Mediclaime	10,000	
80DD:Maintenance of dependent with severe disability	*1,00,000	
80E interest on study loan	50,000	
80U :Severe disability	*1,25,000	
Total Deductions under chapter -VIA		2,85,000
Total Income		6,15,000

For 80U, full deduction available. Amt spent not relevant

## 6. SELF-EXAMINATION QUESTIONS:

1. Enumerate various incomes, exempt from under Section 10.
2. Explain the difference between deduction and exemption with 3 suitable examples.
3. Define Gross Total Income.
4. Explain the deduction u/s 80C of the Income Tax Act, 1961.
5. What is the amount of maximum deductions u/s 80D?
6. Briefly explain the provisions relating to deductions from the gross total income in the case of blind or physically handicapped person.
7. Enumerate exemptions available to foreign nationals in India.

8. Write short notes on:

- a) Gratuity
- b) Leave Salary
- c) Retrenchment Compensation
- d) House Rent Allowance
- e) Dividends
- f) Income of a minor child

9. Manan gets Rs 8,000 by letting out his agricultural land to a tenant who used the land for vermiculture. Clarify if Manan would be eligible for exemption for agricultural income with appropriate reasons.

10. The net profit as per the P & L A/c was Rs. 2,85,000 after taking credit of Rs. 45,000 received on maturity of LIC policy and Rs. 30,000 as Interest from government securities and donation of Rs. 40,000 to BMC for promotion of family planning and Rs. 5,000 as alms to destitute. He also pays Medclaim for Rs. 10,000 in cash and Rs. 10,000 by a credit card and Rs. 25,000 for his 70 year old father . Compute total income for the A.Y.2018-19.

*(Ans: Bus. Income 2,47,000, Other Sources 30,000 GTI 2,77,000, Tot. inc. 2,47,000)*

11. A Resident person, who is physically handicapped (75%) earns a net income of Rs 5, 76,000 from a consultancy business run by him. Compute his total income for the AY 2018-19.

*(Ans : Business income 576,000, deductions, 80U- 75,000 total Income 5,01,000)*



## COMPUTATION OF TOTAL INCOME

### Synopsis

1. Introduction and Objective
2. Computation of Income
3. Illustrations
4. Advance Tax
5. Filing of returns

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### 1. INTRODUCTION AND OBJECTIVES

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The lesson deals with procedural aspect of law in respect of like filing of income tax returns and payment of advance tax and other incidental matters like procedure for computation of total income of individuals, firms and companies, computation of tax liability etc.

*As per the syllabus , law applicable as on as on 01/04/2018 will be considered for computation of total income for the assessment year 2018-19 (previous year 2017—18). Further, the computation will be restricted to not more than two heads of income and two deductions at a time.*

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### 2. COMPUTATION OF TAXABLE INCOME-

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#### 2.1 Taxation of Individuals

Following are the salient features of the procedure relating to preparation of income tax returns for the financial year 2017-18 relevant to assessment year 2018-19.

Step -1 Collection of preliminary details :

- i. Name of the assessee
- ii. Birth date and age
- iii. Gender
- iv. Email address
- v. Mobile number
- vi. PAN
- vii. Aadhar No and linkage with PAN

- viii. GST No , if any
- ix. Residential status
- x. Assessment year-2018-19
- xi. Pervious year-2017-18
- xii. Detail of parents and age
- xiii. Detail of children and age
- xiv. List of Relatives and Associate concerns
- xv. List of investments in saving schemes like LIC, PF etc.
- xvi. Insurance premium paid
- xvii. Premium for insurance
- xviii. Details of handicapped dependents

These details are relevant to ascertain :-

- i. applicable tax rate e.g. woman, senior citizen, super senior citizen etc.;
  - ii. deductions e. g. insurance premium, handicapped assessee, education loan etc. ;
  - iii. disallowances based on relation as in 40A(2); and or
  - iv. exemption based on relation e.g. gifts from relatives u/s 56 , 80U , 80D etc.
2. Computation of income under the five heads of income as per the applicable provisions of law.
  3. Income of other assesseees; e.g. minor children, spouse etc., which are to be included as per the clubbing provisions given in sections 60-64.
  4. Aggregate of income from all such sources excluding the exempt income is called the Gross total Income.
  5. From the Gross Total Income reduce the amount of deductions available in Chapter VI A of the Act.
  6. The result will be the total income.
  7. Compute the tax liability at appropriate rate applicable including special rates applicable to some items of income –horse race, Capital gains on shares.
  8. From the tax liability, any tax rebates are to be reduced.
  9. The result will be the net tax liability, from which any amounts deducted at source (TDS) or Tax Collected at Source (TCS), and taxes paid in advance are reduced.

10. The final balance, if any, is payable as self –assessment tax u/s 140A before filing the return of income. If the advance tax and TDS are more than the tax payable, the excess is shown as the refund due.

### 11. Other Important Points

- a) Agricultural income in excess of Rs 5,000 is added to the total income and tax is computed on such total income. From the tax so computed, tax on agricultural income is separately computed by adding Rs 2,50,000 to the agricultural income. Difference of the two , will be the tax liability
- b) Interest and remuneration payable to partners will be taxable if they are allowed in the hands of firm. Profit from the firm exempt in the hands of the partners as it is taxable in the hands of the firm.
- c) Income of HUF is to be excluded as tax on such income will be payable by the HUF.
- d) Any loan taken from a closely held company is deemed dividend u/s 2(22)(e), if the hands of the individual if the individual and his relatives hold 10% voting power therein.

### 12. Income Tax Rates for Assessment Year 2018-19

- A. In case of an Individual (resident or non-resident) or HUF or Association of Person or Body of Individual or any other artificial juridical person

Slab	Tax Rate
<b>Individuals</b>	
First Rs 2,50,000	Nil
2,50,001-5,00,000	5%
5,00,001-10,00,000	20%
10,00,001 and above	30%
<b>Senior Citizens- (Age 60 years Anytime during the P.Y.)</b>	
First Rs 3,00,000	Nil
3,00,001-5,00,000	5%
5,00,001-10,00,000	20%
10,00,001 and above	30%

<b>Very Senior Citizens</b> (Age 80 years Anytime during the P.Y.)	
First Rs 5,00,000	Nil
5,00,001-10,00,000	20%
10,00,001 and above	30%
Surcharge on Income Tax ( For all)	
if total income Exceed Rs 50 lakh but below Rs 1 crore	10%
Exceeds Rs one Crore	15%
Surcharge shall not exceed 70% of the amount of income tax payable on income over Rs 50 lakh /1 Cr.	
Rebate under 87A- Rs 2500 or 100% of income tax (whichever is low) for the individuals having total income Rs 3,00,000 or less. Effectively exemption limit for is Rs 3 lakh)	
Education Cess (EC) on Tax amount	2%
Secondary and Higher Education Cess on tax and surcharge (SHEC) on tax amount	1%
No basic exemption or allowance or expenditure shall be allowed to the assessee under any provision of the Income-tax Act, 1961 in computing deemed income., unexplained income, investments, money etc. chargeable under sections 68/69/69A/69B/69C/69D [Section 115BBE] Set-off of losses not permissible against such income. These provisions were brought in the wake of demonetization of high denomination currency notes.	

**PROCEDURE OF COMPUTATION:**

<b>A. Preliminary Information</b>
Name and address of the assessee , PAN GST No E mail Residential Status Assessment Year 2018-19 Previous Year -2017-18

<b>B. Computation of Total Income</b>
1. Income from Salary 2. Income from House Property 3. Profit and Gain of business and Profession 4. Capital Gains 5. Income from Other Sources
<b>C. Gross Total Income</b> ( Total of B 1 to 5) ( excluding exempt income )
<b>D. Deduction under chapter VIA</b>
<b>E. Total Income</b> [D-E]
<b>F. Ascertain Tax Liability</b> Tax at applicable rates + Surcharge ( after marginal relief) Add –Education Cess -2 % on tax Add Secondary and Higher Education Cess @ 1% of tax
<b>G. Less : Rebates, Advance Tax , TDS , TCS</b>
<b>H. Add : Interest Payable to Government</b>
<b>I Self Assessment Tax / Refund Due ( F-G+H)</b>

### Illustrations.

1. Ascertain the tax liability of R, whose total income is Rs 5 lakh. A also show if there will be any difference in the tax liability if he also has agricultural income Rs 1 lakh.

### Solution

I Tax on Income of Rs 6 lakh

	Rs
Tax on first Rs 2,50,000	NIL
On Next Rs 2,50,000@ 5%	12,500
Total	12,500
Less Rebate U/s 87A	0
	12,500
Add Cess EC+ SHEC -3%	375
Total Tax on Rs 5,00,000	12,875



**II If Income includes Agricultural income**

(a) Tax on Total income plus agricultural income

Rs 5 lakh +1 lakh = Rs 6 lakh

	Rs
Tax on first Rs 2,50,000	NIL
On Next Rs 2,50,000 @ 5%	12,500
On Balance Rs 1,00,000 @ 20%	20,000
	32,500
Add Cess EC+SHEC	,975
Total Tax on Rs 7,00,000	33,475

(b) Tax on basic limit plus agriculture income

-Rs 1,00,000+2,50,000 = Rs 3,50,000

	Rs
Tax on first Rs 2,50,000	NIL
On Next Rs 1,00,000 @ 5%	5,000
Rebate u/s 87A	2500
	2,500
Add Cess EC+SHEC	75
Total Tax on Rs 3,50,00	2,575

(c) Tax payable (a)- (b) or Rs 33,475 – 2,575= Rs 30,900

**3. ILLUSTRATIONS**

1. Compute total income of Mangesh for the AY 2018-19 from the following and also compute the tax liability.:

<b>Profit and Loss Account for the year ended 31st March, 2018</b>			
<b>Particulars</b>	<b>Rs.</b>	<b>Particulars</b>	<b>Rs.</b>
To Salaries	2,00,000	By Gross Profit	9,25,000
To Rent	30,000	By Interest on FD	10,000
To postage	10,000	By Dividend-Indian	25,000
To Stationery & Ptg	37,000	By dividend- Co-bnk	10,000
To Advertising Exp.	25,000	By Lottery Prize	15,000
To Repairs to Office	25,000	By Debenture Int.	5,000
To Conveyance	20,000		
To Income Tax	15,000		
To IT scrutiny Exp	8,000		

To CA Fee for Tax	10,000		
To Misc. Expenses	20,000		
To Depreciation	10,000		
To Donation	10,000		
To Net Profit	5,70,000		
	<u>9,90,000</u>		<u>9,90,000</u>

**Additional Information:**

- (1) Salaries include bonus due to employees Rs. 30,000 which was not paid before the due date of filing of Income Tax return.
- (2) Rent is paid for the residential house of Mangesh.
- (3) Repairs to office include a one-time cash payment of Rs. 20,000 on 18/08/2017.
- (4) Miscellaneous expenses include purchase of shares of an Indian company for Rs. 20,000.
- (5) Donations include charity of Rs. 15,000 and Rs 5,000 given to GIC for maintenance of his handicapped brother.
- (6) Depreciation as per Income tax rules is Rs. 10,000.

**Solution:**

<b>Computation of Total Income of Mangesh for A.Y. 2018-19</b>		
<b>Particulars</b>	<b>Rs</b>	<b>Rs</b>
Income from Business		
Net Profit as per P/L Account		5,70,000
<u>Add: Disallowable Expenditure</u>		
Bonus due but not paid u/s 43B	30,000	
Rent (Personal)	30,000	
Purchase of share (Misc Exp)	20,000	
Income Tax	30,000	
Donation (10,000+ 5,000)	15,000	
Depreciation	<u>10,000</u>	<u>1,35,000</u>
		7,05,000

<b><u>Less: Income Considered Separately</u></b>		
Interest on Bank FD	10,000	
Dividend from Indian Company	25,000	
Dividend from Co-operative Bank	10,000	
Winning from Lottery	15,000	
Interest on Debentures of Ltd Co	<u>5,000</u>	<u>65,000</u>
		6,40,000
<b><u>Less: Depreciation as per rules</u></b>		<u>10,000</u>
Business Profits		6,30,000
<b><u>II Income from Other Sources</u></b>		
Interest on Bank FD	10,000	
Dividend from Indian Company ( Exempt)	0	
Dividend from Co-operative Bank	10,000	
Winning from Lottery	15,000	
Interest on Debentures of Ltd Co	<u>5,000</u>	
Income from Other Sources		40,000
Gross Total Income		6,70,000
Less: Deductions- under Ch. VI-A		
80-DD: Maint. of handicapped dependant		<u>1,00,000</u>
Total Income		<u>5,70,000</u>
Tax Payable		29,900
Surcharge -3%		<u>898</u>
Total Tax Payable		30.798

*Note: To claim deduction u/s 80DD, it is not necessary that there must be actual expenses incurred on handicapped dependent.*

2. Compute the total income and ascertain the tax liability of Sam for the A.Y. 2018-19 from the following Profit and Loss Account:

<b>Profit and Loss Account for the year ended 31st March, 2018.</b>			
<b>Particulars</b>	<b>Rs.</b>	<b>Particulars</b>	<b>Rs.</b>
To Salaries	1,30,000	By Gross Profit	10,67,000
To Rent	30,000	By UTI Dividend	9,000
To Entertainment Exp	18,000	By LIC Mutual	5,000
To Printing & Stn	25,000	By Gift from Mother	50,000
To Advt Exp	50,000	By Winning- Puzzle	12,000
To Motor Car Exp	30,000	By Interest on NSC	3,000
To Drawings	60,000		
To Income Tax	16,000		
To Embezzlement -Employee	7,000		
To Staff Welfare Exp	70,000		
To Donation	30,000		
To Depreciation	35,000		
To Net Profit	<u>6,45,000</u>		
Total	<u>11,46,000</u>		<u>11,46,000</u>

**Additional Information:**

- (1) Depreciation as per Income tax rules is Rs. 38,000.
- (2) Staff Welfare expenses include Rs. 20,000 for his own treatment.
- (3) 50% of the rent is paid for his residential house
- (4) Printing includes Rs. 5,000 paid for printing marriage cards for his daughter's marriage

**Solution:**

<b>Computation of Total Income of Sam for AY: 2016-19</b>			
	<b>Rs</b>	<b>Rs</b>	<b>Rs</b>
<b>I Income from Business</b>			
Net Profit as per P/L Account		6,45,000	
<b>Add:</b> Disallowable Expenditure			
Own Medical Expenses	20,000		
Rent (Personal)	15,000		
Printing of Marriage Cards	5,000		
Income Tax	16,000		
Donation	30,000		
Depreciation	35,000		
Drawings	<u>60,000</u>	<u>1,81,000</u>	
<b>Less:</b> Income Considered Separately		8,26,000	
UTI Dividend	9,000		
Income from LIC Mutual Fund	5,000		
Gift from Mother	45,000		
Winning from Crossword Puzzle	12,000		
Interest on NSC	<u>3,000</u>	<u>74,000</u>	
		7,52,000	
<b>Less:</b> Depreciation as per rules		<u>38,000</u>	
<b><u>Income from Business</u></b>			7,14,000
<b>II Income from Other Sources</b>			
UTI Dividend (exempt)		Nil	
LIC Mutual Fund (exempt)		Nil	
Gift from Mother (exempt)		Nil	
Winning from Crossword Puzzle		12,000	
Interest on NSC		<u>3,000</u>	
<b><u>Income from Other Sources</u></b>		<u>15,000</u>	<u>15,000</u>
<b>Gross Total Income</b>			7,29,000
<b><u>Less:</u></b> Deductions under Chapter VI-A			
80-C NSC Interest Re-invested		3,000	<u>3,000</u>
<b>Total Income</b>			<b>7,26,000</b>
Tax Payable on Income			57,700
Surcharge @3%			1,731
Total Tax			59,431

3. Jain a Chartered Accountant gives the following Receipt and Payments Account for the year ended 31st March, 2018.

Receipts	Rs.	Payments	Rs.
To Cash & Bank B/f	70,000	By Office Rent	6,000
To Fees from Clients (net)	6,60,000	By Ptg & Stn	5,000
To Hon. For Articles	40,000	By Gifts to Staff	11,000
To Dividend-Indian Co	5,000	By General Exp.	14,000
To Interest- Bank SB A/c	2,000	By Motor Car Exp	16,000
To Interest.-on PO SB A/c	3,000	By Telephone Exp	12,000
To Interest- Bank FD	8,000	By Income Tax	40,000
To Int. on Govt Securities	6,000	By Drawings	1,20,000
To Sale of Motor Car	1,00,000	By Car Insurance	12,000
		By conveyance	13,000
		By Tally Software	19,000
		By LIC Premium paid	64,000
		By Salaries to Staff	12,000
		By Computer (cost)	50,000
		By Cash & Bank C/f	5,00,000
TOTAL	8,94,000	TOTAL	8,94,000

**Additional Information:**

- (1) Computer was purchased on July 1, 2017 and depreciation is allowed @ 60% on the same.
- (2) Opening WDV of Block of Motor Cars consisting of 2 Motor Cars was Rs. 2,50,000 and depreciation is allowed @ 20% on the same.
- (3) Personal use of the Motor car is estimated to be 25%.
- (4) Fees from clients are after TDS of Rs. 20,000.
- (5) General expenses include a sum of Rs. 4,000 given to his daughter as birthday gift.
- (6) Drawings include a sum of Rs. 30,000 given premium for self and family of Rs. 20,000 and Rs. 10,000 for his father, who is a senior citizen/.

Compute the net taxable income of Joshi for the AY 2018-197.

**Solution:**

<b>Computation of Total Income of S. V. Joshi –Asst. Year 2018-19</b>		
<b>Particulars</b>	<b>Rs</b>	<b>Rs</b>
Income from Profession		
Fees from Clients	6,60,000	
Add: Tax Deducted at Sources	<u>20,000</u>	6,80,000
<b>Less: Allowable Expenses</b>		
Depreciation on Motor Car	22,500	
Motor Car Expenses @ 75%	12,000	
Office Rent	6,000	
Printing and Stationery	5,000	
General Expenses	10,000	
Motor Car Insurance @ 75%	9,000	
Telephone Expenses	12,000	
Conveyance Expenses	13,000	
Depreciation on Computer @ 60%	30,000	
Salaries to Staff	2,000	
Gifts to Staff	<u>11,000</u>	-
<b>Income from business</b>		<u>1,32,500</u>
		8,12,500
<b>II Income from Other Sources:</b>		
Receipts for Writing Articles	40,000	
Interest on Fixed Deposit	8,000	
Interest on Government Securities	6,000	
Interest on SB Account	2,000	
Interest on PO Savings Account (exempt)	Nil	
Dividend from Indian Companies (exempt)	<u>Nil</u>	
Income from Other Sources	<u>56,000</u>	<u>56,000</u>
<b>Gross Total Income</b>		<u>8,68,500</u>
<b>Less: Deductions under Chapter VI-A</b>		
80-C Life Insurance paid	64,000	
80-D Medical insurance Premia : Rs 30,000 for father + Rs. 25,000 for self=maximum	<u>55,000</u>	<u>1,19,000</u>
<b>TAXABLE INCOME</b>		7,49,500
<b>Tax Payable on Income</b>		62,400
<b>Surcharge @ 3%</b>		1,872
<b>Total Tax</b>		63,272

4. Compute total income and tax liability on the income of X from the particulars given below:

Basic pay: Rs. 26,000 pm

Education allowance for one child: Rs. 300 pm

Bonus: Rs. 26,000

Salary in lieu of leave: Rs. 25,000

He contributed Rs. 18,400 to the recognized provident fund and an equal amount was contributed by his employer. He received Rs. 14,000 from bank as interest, dividend of Rs. 10,000 from a foreign company and winning from horse race of Rs. 42,500 (gross). He paid Rs. 2,500 professional tax.

### Solution

Computation of Total Income – A.Y. 2018-19		
Basic Salary 36,000 X 12)		4,32,000
Education allowance	(300 X 12) 3,600	
Less: Exempt	(100 X 12) <u>1,200</u>	2,400
Bonus		26,000
Leave Encashment		25,000
		<b>4,85,400</b>
Less Profession Tax		2,500
Income from Salaries		<b>4,82,900</b>
Dividend from foreign company	10,000	
Winnings from Horse Race	42,500	
Bank Interest	14,000	
Income from Other Sources		66,500
Total Income		5,49,400
Tax Payable		23,330
Cess		700
Total Tax		24,030

## 4. PAYMENT OF ADVANCE TAX -SECTIONS 207-219

**4.1** All assesseees are required to pay advance tax on their current income from all sources, if tax liability for payment of tax is Rs.10,000 or more- (S 208) .

### 4.2. Amount and due Dates for payment of Advance Tax;

Advance tax is payable four instalments by the companies and in three instalments by other assesseees as per the following table:



<b>PAYMENT OF ADVANCE TAX</b>	
<b>Due date of Instalment</b>	<b>Tax Payable as % of total tax</b>
15 June	Not Less than 15%
15 September	Not Less than 45% Less tax paid (30%)
15 December	Not Less than 75% Less tax paid (30%)
15 March	Not Less than 100% Less tax paid (25%)
Tax payable by assessee covered under section 44AD /44ADA for presumed taxation 100% of tax payable before 15 March	
Payment made by 31 <sup>st</sup> March considered Advance Tax	

#### 4.3. Miscellaneous;

- The Assessing officer may, serve a notice upon the assessee to pay advance tax on the basis of the last regular assessment and if the assessee does not pay the advance tax he/it shall be deemed to be an assessee in default.
- For shortfall / non- payment assessee will be liable to pay interest U/s 234 B and 234 C.

#### Illustration

1. Liability for advance tax payment of an individual income is estimated to be Rs 8,00,000 for F. Y. 2017-18 .

Tax payable on current income of Rs10,00,000 works out at Rs 1,15,875 , which will be payable as under:-

Instalment	Due Date	Amount	Cumulative
I - 15%	15 June ,2017	17,381	17,381
II-45%	15 September,2017	34,763	52,144
III-75%	15 December,2017	34,763	86,906
IV- 100%	15 March,2018	28,972	1,15,875

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## **5. FILING OF RETURNS- SEC 139(1) AND 139(5)**

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### **5.1. LIABILITY FOR FILING RETURNS:**

Section 139(1) casts the burden of filing return of income or loss on assessee. For some of the assessee it is mandatory to file on or before the due date a return of income or loss for the previous year in prescribed form, verified in prescribed manner and setting forth such other particulars as may be prescribed

For the following, assessee filing the return of income is mandatory:

#### **1. Companies and Firms**

2. Every Person (other than a company or a firm,) if his total income or the total income of any other person in respect of which he is assessable under the Act during the previous year exceeds the basic exemption limit.

(3) Further, every person, being an individual or a HUF or an AOP or BOI or an artificial juridical person—

– whose total income or the total income of any other person in respect of which he is assessable under this Act during the previous year

– Without giving effect to the provisions of section 10A or 10B or 10BA or Chapter VI-A exceeds the basic exemption limit is required to file a return of his income or income of such other person—

2. For companies and other assessee having tax audit or having income of Rs 10 lakhs or more , filing of return in a digitally signed electronic form is mandatory.(Section 139D)

### **5.2. Due date for filing return of income;**

A return of income has to be filed on or before the due date of filing return. , 'Due date' means -

- (a) 30th September of the assessment year, the assessee being -
  - (i) a company; or
  - (ii) a person (other than a company) whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force; or

(iii) a working partner of a firm whose accounts are required to be audited under the Income-tax Act, 1961 or any other law for the time being in force.

**(b) 31st July of the assessment year**, in the case of any assessee other than those covered in (a) above.

#### **Illustrations : -**

1. XYZ Limited shall file the return of income for the A.Y. 2018-19 on or before 30/09/2018
2. X having income of Rs 50,000, is not liable to file his return of income.
3. Z has a loss of Rs 2 lakhs, and his accounts are not audited, due date in his case will be 31/07/2018

#### **5.3 Revised return – Section 139(5)**

If any person having furnished a return under section 139(1) or in pursuance of a notice issued under section 142(1), discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant assessment year or before completion of assessment, whichever is earlier.

From the above, it is apparent that a belated return and it cannot be revised. In any case, a belated return can be filed under S 139(4) before the end of the assessment year i.e. 31/03/2019 in case of a belated return *for* AY 2018-19.

#### **5.4 Other Points:**

- A. CBDT is vested with the powers to prescribe forms of return
- B. A return must be properly verified and signed by an individual or partner of a firm or a director of company etc.
- C. Consequences of late filing of return ;
  - Liability for Interest @ 1% per month U/s 234A
  - Penalty of Rs 5,000 if return filed before 31st December and 1,0000 if filed thereafter. Return cannot be filed after March 31,2019 U/s 271
  - **Certain exemptions cannot be claimed.** Including u/s 11- Charities, 10(38)- LTCG etc.
  - Return cannot be revised
  - Loss is not allowed to be carried forward.
- D. Return will not be treated defective if Self –assessment tax not paid
- E. A return cannot be revised if filed in response to notice u/s 142.

F. Belated return cannot be filed beyond the end of the assessment year

**6. Prescribed returns for the Asst Year 2018-19 are as follows**

- ITR-1: For Individuals being a resident other than not ordinarily resident having Income from salaries, one House Property, other source (Interest etc.). and having total income upto Rs. 50 lakh
- ITR-2: For Individuals and HUF not having income from profits and gains of business or profession
- ITR-3: For Individuals and HUF having income from profits & gains business & profession
- ITR-4 (SUGAM): For presumptive income from business & profession
- ITR-5: For persons other than,- (i) individual, (ii) HUF, (iii) company and (iv) person filing Form ITR-7
- ITR-6: For Companies other than Companies Claiming Exemption under section 11
- ITR-7: For Companies including Companies required to furnish return under section 139(4A), or section 139(4B), or section 139(4C), or section 139(4D), or section 139(4E), or section 139(4F)

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**6 SELF ASSESSMENT QUESTIONS**

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1. Discuss the provisions for payment of advance tax. .
2. Explain advance tax liability of Ms. ABC if her income will be Rs 15,00,000 for the financial year 2017-18.
3. What are the due dates of payment of advance tax by different assessees?
4. Ram gives you the Profit and Loss Account for the year ended 31<sup>st</sup> March, 2018. You are required to compute the total income of Ram for AY 2018-19 assuming that Ram has paid LIC premium of Rs. 5,000.and interest of Rs 25,000 for educational loan of his son.

Profit and Loss Account for the year ended 31 <sup>st</sup> March 2018			
Particulars	Rs.	Particulars	Rs.
To Opening Stock	1,60,000	By Sales	18,50,000
To Purchases	14,05,000	By Closing Stock	1,08,500
To Salaries	1,84,350	By Winnings from Lottery	5,000
To Office Expenses	70,040	By Interest on fixed deposits with bank	15,000
To Office Rent	20,000	By Interest on RBI Bonds (exempt u/s 10)	16,000
To Staff Welfare	13,000	By bad debts recovered	20,000
To Advertisement Exp.	65,000	By dividend from Indian companies	9,000
To Donations	5,000		
To R.D.D.	10,000		
To Mediclaim (Cash)	21,000		
To Insurance	10,000		
To Income Tax	8,000		
To Depreciation	20,000		
To Net Profit	32,110		
	<b>20,23,500</b>		<b>20,23,500</b>

**Additional Information:**

- Advertisement expenses include Rs. 11,000 for advertisement in a souvenir of a local political party and Rs. 20,000 for introducing a new product in the market.
  - Donations are given for books to poor students
  - On August 10, 2015 furniture of Rs. 20,000 was purchased on credit the payment for which was made on April 2, 2016. The same was not recorded in the books of accounts. The rate of depreciation on furniture is 15% per annum. On other fixed assets, depreciation was charged exactly as per I.T. Rules.
  - Bad debts recovered were allowed during the A.Y 2009-10.
5. Sheela who is suffering from a permanent disability, received the following emoluments from SWY Ltd, her employer for last 10 years during the year ended March 31, 2018: You are required to compute her total income for the AY 2018-19.

Basic Salary (Net) April 1, 2017 to September 30, 2017	Rs. 10,000 p.m. (TDS Rs 600 P.M) , (Profession Tax Rs 1,250 P.M.)
October 1, 2017 to March 31, 2018	Rs. 12,000 p.m. ( TDS Rs. 700 p.m. ) (Profession Tax Rs 1,250 P.M.)
Dearness Allowance	40% of basic salary
Entertainment Allowance (Actually spent Rs. 300 p.m.)	Rs. 500 p.m.
Bonus for the year	Rs. 8,000
Conveyance Allowance (Actually spent Rs. 800 p.m.)	Rs. 1,000 p.m.

- 1) Commission from employer is 1% of turnover of Rs. 10 lakhs;
- 2) She needs a personal physical attendant whose salary of Rs. 2,000 p.m. was paid by the employer.
- 3) She paid Mediclaim insurance of Rs. 12,000 for himself and Rs. 5,000 for his brother. Statutory Provident Fund @ 10% of basic salary was deducted from her salary.

6. Mrs. Sweety aged 66 years took voluntary retirement on January 1, 2018 from a private bank after completing 26 years and 11 months of service. She furnishes you with the following information: Compute her net taxable income for the AY 2018-19. After retirement, She delivers lectures as guest faculty in Indian Institute of Banking for which She receives honorarium of Rs. 22,000. She paid Mediclaim premium of Rs. 13,200 by crossed cheque. She invests Rs. 50,000 in National Saving Certificates. She received gifts from her colleagues for Rs. 3,00,000 in January 2018.

Basic Salary	Rs. 2,800 p.m.
Dearness Allowance	128% of basic salary
Conveyance Allowance (actual expenses. For official purpose Rs. 600 p.m.)	Rs. 900 p .m
Gratuity	Rs. 1,29,200
Commuted pension	Rs. 67,500
Leave Encashment	3 months basic salary
Uncommuted pension	Rs. 2,500 p.m.
Voluntary retirement compensation	Rs. 8,72,000
Profession tax paid	Rs. 1,200

7. Compute total income of Krishna for the AY 2018-197 from the Profit and Loss Account of his proprietary concern for the year ended March 31, 2018

Particulars	Rs.	Particulars	Rs.
To Opening Stock	2,34,000	By Sales	12,40,000
To Purchase	10,00,000	By Closing Stock	2,05,000
To Office Salaries	57,000	By Income Tax Refund	15,000
To Proprietor's Salaries	30,000	(including interest Rs. 2,000)	
	25,000	By Dividend from UTI	20,000
To Bad Debts	10,500	By Dividend from Y Ltd (an Indian Company)	25,000
To Advertisement	4,500	By Interest on PPF	
To Fire Insurance Premium	6,000	By Lottery prize received	5,000
To Conveyance Exp	25,000		10,000
To Interest on Proprietor's Funds			
To Medical Expenses	20,000		
To General Expenses	35,000		
To Wealth Tax paid	5,000		
To Residential Telephone expenses	14,000		
To Depreciation	30,000		
To Net Profit	20,000		
	<hr/>		<hr/>
	15,20,000		1520,000

#### Additional Information

- The residential telephone is used half the time for office work.
- Purchases include Rs. 1,00,000 paid for cash purchases, exceeding the limits prescribed under Section 40A(3).
- General expenses include advance income tax of Rs. 10,000 paid during the year and Rs. 500 for purchase of lottery tickets.
- Depreciation allowable as per Income Tax Rules Rs. 25,000
- Agricultural income Rs.70,000.

8. Compute total income of R with 40% disability, from following information regarding his house property for the AY 2018-19

Particulars	HOUSE I	HOUSE II
Fair Rent	40,000	60,000
Municipal Valuation	55,000	50,000
Rent received	60,000	--
Municipal tax:		
(a) Paid by the tenant	4,000	--
(b) Paid by Ri	6,000	5,000
Interest on capital borrowed (due but not paid) for the purpose of construction of house property	6,000	13,000
Ground Rent	2,000	--
Insurance premium paid	1,500	--
Other information:		
(i) Interest from debentures in Y Ltd	12,000	--
(ii) Dividend from UTI	5,000	--
(iii) Bank interest from SBI	3,500	--
(iv) Winning from lottery	28,000	--
(v) Interest from Post Office Savings Account	5,000	--
(vi) Dividend from a co-operative society	5,000	--





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## SECTION-II: INDIRECT TAXES

### GST

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# 1

## INTRODUCTION TO GST

### Synopsis :

1. Introduction and Objective
2. Concept of GST
3. Need for GST
4. Dual GST Model
5. Goods and services tax network (GSTN)
6. Definitions of various terms
7. Self-Examination Questions

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### 1. INTRODUCTION AND OBJECTIVES

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The lesson explains the concept, need and objective of Goods and Service Tax (GST) in India, its framework, the roadmap for its implementation, benefits accruing from implementation of GST and other incidental matters. Further, the lesson takes up some basic terms used in GST laws.

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### 2. The CONCEPT - WHAT IS GST

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Goods and Service Tax (GST) is an indirect tax, which is levied only on the value added at each stage of supply chain comprising of manufacture, sale and consumption of taxable goods or services.

The GST provides for a comprehensive and continuous chain of tax credits beginning from the manufacture or production of goods or provision of service up to the retailer or consumer to ensure that

- (a) There is no cascading effect by levying tax on tax at each stage; and
- (b) The tax is levied only on the value added at each stage of supply.

At each stage of supply, a supplier of goods or service or both can avail input credit for the tax paid on the purchase of goods or services or both and set off this credit against the GST payable on the supply of goods and services or both made by him to the

next stage. GST makes no difference between goods and services and both are treated at par and taxed at a single rate.

It is only the final consumer, who bears the GST charged by the last supplier in the supply chain, with set-off benefits at all the previous stages.

India has a dual GST model, with identical tax rate applied by the Central Government called Central GST (CGST) and State GST (SGST). For inter-state transactions, Integrated GST (IGST) is levied, which is equal to  $CGST = SGST$ .

The concept of GST may be explained by the following example.

In this example a three-tier supply chain is assumed comprising of A the manufacturer, B the distributor and C the consumer. A prices goods at Rs. 40,000 and supplies it to B. B supplies it to C at Rs. 50,000 with value addition of 25%. Rate of tax is assumed to be 6% each CGST/ STGST. Tax position will be as follows;

Particulars	A to B	B to C	Tax Payable By B
Price charged for supply	40000	50000	
CGST @ 6%	2400	3000	600
SGST @ 6%	2400	3000	600
Total price charged	44800	56000	

### Notes

- A pays Rs. 4800 (2400 each CGST & STGST).
- B's gross liability is Rs. 6000 (3000 each CGST & STGST).
- B gets input credit for tax (ITC) paid to A 2400 each for CGST & STGST.
- B has to pay only Rs. 1200 (Rs. 600 each for CGST & STGST)
- Both the State Government and the Central government get tax of Rs. 3000 each (Rs 2400 from A and Rs. 600 from B)
- If ITC is not allowed, then B's GST liability would be Rs. 6,000. This is called as cascading effect of tax)
- Assuming A and B belong to different states or union territories, then A will charge IGST of Rs. 3000 (12%) and B will get ITC of Rs. 3000 against IGST and pay the balance just as before. This is an example of seamless credit flow.
- C being the in the supply chain, cannot claim any input credit and has to bear the total tax burden.

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### 3. NEED FOR GST

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India had a multi-tier indirect tax regime comprising of -

- overlapping taxes
- levied by different authorities
- at different levels
- Denied credit or set off for the taxes paid at the previous stages.

Credit for the VAT paid on the inputs was denied to the manufacturer and the service provider and credit for the excise duty or the service tax paid was denied to the seller only because the excise duty and the service tax were the central taxes, but the VAT was a state tax.

These taxes were not mutually exclusive. For instance, intra-state sale of excise-paid manufactured goods attracted VAT on the gross value of the goods, which included the basic value, the excise duty charged by manufacturer and the profit by dealer.

As a result, the indirect- tax structure was a complex cobweb of rules and regulations in different parts of the country having cascading tax effect. There was no credit at all for local taxes like entry tax and octroi imposing hindrance in smooth movements of goods across the country besides creating scope for arbitrage of rates at different places, interstate smuggling and grey markets for goods and services. India needed a uniform tax regime with lower rates and stringent implementation.

The flaws in the indirect tax structure created the need for a broad- based uniform, integrated central tax with lower tax rates, efficient implementation and free credit across the board for various taxes paid and reduce the cascading effect of multiple taxes, which subsumes all the taxes levied on the sale of goods or provision of services by both the centre and the states and provide a larger pull for set off of taxes. These reasons may be summed up as under:-

- a. Integration of different taxes such as excise, VAT, luxury tax, entertainment tax, Octroi and CST so as to avoid multiple taxation of a transaction as both goods and services.
- b. Replacement of multiple tax levies by a uniform tax regime in respect of goods and services both.
- c. Abatement of the cascading tax burden of tax on tax at different levels.
- d. Introduction of an indirect, comprehensive, broad based consumption tax for any product or service throughout India

- e. Provision for a continuous chain of credits from the original producer or service provider to the retailer or end consumer for taxes paid at earlier stages i.e. input credit to ensure the removal of cascading effect of multiple taxes.
- f. Imposition of tax only on the value added at every stage in the supply chain instead of tax on origin or manufacture of goods.
- g. Setting up an efficient tax regime free of corruption and bureaucratic red-tape to enable simplified tax compliance.
- h. Creation of a national market for goods and services.
- i. Safeguarding the interests of the states by opting for a dual-model GST with inbuilt provisions for CGST, SGST, UGST and IGST.

### **Principles of subsuming taxes**

Accordingly several taxes were subsumed or absorbed in the GST, based on the following principles :

- a. Only indirect taxes on goods and services were to be subsumed in GST.
- b. Such taxes were part of the supply chain i.e. manufacturer , service provider or retailer or consumer ;
- c. The taxes resulted in free flow of tax credits in intra and inter-State levels; and
- d. The taxes which were not specifically unrelated to supply of goods or services, e.g. stamp duty, municipal taxes etc. were not subsumed in GST.
- e. The subsuming of the taxes maintained revenue neutrality and fairness between the central and the states.

### **Taxes subsumed or absorbed in GST**

Based on the above principles, following taxes have been subsumed in GST:

#### **A. Central Taxes**

- (a) Central Excise Duty (CENVAT)
- (b) Additional Excise Duties
- (c) Excise Duty under the Medicinal &Toiletries Preparations (Excise Duties) Act 1955
- (d) Service Tax
- (e) Additional Customs Duty, commonly known as Countervailing Duty (CVD)
- (f) Special Additional Duty of Customs – 4% (SAD)
- (g) Surcharges and Cesses levied by Centre wherever they are in the nature of taxes on goods or services e.g. cess on rubber, tea, coffee, national calamity contingent duty etc.
- (h) Central Sales Tax phased out

**B. State / Local Taxes**

- (a) VAT / Sales tax
- (b) Entertainment tax except levied by the local bodies
- (c) Luxury tax
- (d) Taxes on lottery, betting and gambling
- (e) State cesses and surcharges relating to supply of goods and services
- (f) Octroi and entry tax
- (g) Purchase tax

**C. Taxes not subsumed in GST**

- (a) Basic Customs Duty levied on Import of goods into India.
- (b) Exports Duty imposed on export of goods are not available in India in abundance,
- (c) Road and Passenger tax ,
- (d) Toll tax
- (e) Property tax
- (f) Stamp duty
- (g) Electricity duty

**D. Treatment of Specific goods****a) The Alcoholic Liquor for Human Consumption**

Under Article 366, clause 12A, the supply of the alcoholic liquor for human consumption is outside the ambit of GST. The States will continue to impose tax on it. Moreover, CST on inter-state sales of alcohol products would also continue.

**b) Tobacco Products**

Tobacco and tobacco products being ‘Sin’ goods will be subjected to GST subject to a separate excise duty by the Centre.

**c) Petroleum, Crude, High Speed Diesel (HSD) , Motor Spirit, Natural Gas and Aviation Turbine Fuel(ATF)**

The states will continue to levy VAT on intra-state sales of petroleum products. Inter-state sales would continue to attract Central Sales Tax (CST). However, these products may be transitioned into the GST regime on a future date to be notified by the GST Council. Moreover, these products are also subject to levy of excise duty imposed by the Centre in addition to the VAT or GST.

**d) Newspapers and newspaper advertisements**

While there is no GST on newspaper, GST, advertisements are subject to levy of GST.

#### 4. DUAL GST MODEL

GST is a uniform destination-based tax applicable on all transactions involving supply of goods or services, or both, for a consideration subject to specified exceptions throughout India including the State of Jammu and Kashmir. India has followed Canada and Brazil and adopted the dual GST model, while most of the countries have a single GST model.

Under the dual GST model, both the Centre and the states/UT may concurrently levy GST on intra-State taxable supply of goods or services or both.

Accordingly, the dual model of GST adopted in India comprises of the following components in respect of intra-state supply of goods or services or both :-

Type of GST	Levied and collected by
a) The Central Goods and Service Tax (CGST)	Centre under the CGST Act, 2017 passed by the parliament,
b) (i) The State Goods and Service Tax (SGST)	The states under the respective SGST Acts passed by the legislature of the concerned states and the union territories with their own legislatures viz. Delhi and Puducherry,
b(ii) The Union Territories State Goods and Service Tax (UTGST)	The Union territories without State legislatures viz. Andaman and Nicobar Islands, Lakshadweep, Dadra and Nagar Haveli, Daman and Diu and Chandigarh under the provisions of UTGST Act, 2017 passed by the parliament.
c. Integrate State Goods and Service Tax (IGST)	Centre under the IGST Act, 2017 passed by the parliament in respect of inter-state supplies.

By and large, CGST and SGST/UTGST rates are equal and IGST is almost equal to the sum total of CGST and SGST/UTGST. Hence, it can be said that GST in respect of intra-state supplies is equally shared by the concerned state and the Centre.

For instance, If CGST rate in case of intra state supply of goods or service or both, is 12%, then 6% will be the CGST and 6% will be the SGST/UTGST. IGST will be levied at 12% on inter-state supplies.

Further, the SGST acts of the states/UT, UTGST Act, 2017 and IGST Act, state are by and large uniform in respect of the basic features of the tax, chargeability, taxable event, taxable person, classification and valuation of goods and services, procedure for collection and levy of tax etc. to keep the concept to of dual GST in harmony.

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## **5. GOODS AND SERVICES TAX NETWORK (GSTN)**

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GST regime is technology based. It seeks to avoid personal interface with taxpayers and insists on online compliance. With this objective, Goods and Service Network (GSTN) was incorporated as a special purpose vehicle as a non –profit company under section 8 of the Companies Act, 2013 with an initial equity capital of Rs. 10 crore; 24.5% contributed by the Centre, 24.5% by all States including Delhi and Puducherry, and the balance 51% equity by non-Government financial institutions.

### **Objects**

The company set up a single portal [www.gst.gov.in](http://www.gst.gov.in) with the objects:

- (a) to provide IT infrastructure and all GST related services to the Central and the State Governments, taxpayers and other stakeholders for implementation of the Goods and Services Tax (GST); and
- (b) to establish a uniform interface linkage for the taxpayer and a common and shared IT infrastructure between the Centre, Union Territories and States.

The portal is accessible over Internet by taxpayers and tax professionals like chartered accountants, tax advocates, banks, accounting, tax authorities and other stakeholders and intranet by tax officials etc.

### **Functions of the GSTN**

GSTN provides to the taxpayers three front-end services, viz. registration, payment and return through GST common portal. Its main functions are as under:-

- a) To facilitate registration of the taxpayer. GSTN takes help of IT, ITeS, and financial technology companies called GST Suvudha providers(GSP), who provide mechanism to receive GST returns from the taxpayers and forward the returns to Central and State authorities;
- b) To develop applications to be used by taxpayers for interacting with the GSTN and facilitate the taxpayers in uploading invoices

as well as filing of returns and act as a single stop shop for GST related services with the help of GSPs;

- c) To customize products that address the needs of different segment of users. GSPs may take the help of Application Service Providers (ASPs) who act as a link between taxpayers and GSPs;
- d) To compute and settle IGST with the concerned states/UT;
- e) To match payment of tax by the tax payers with the banking network;
- f) To generate MIS reports from the information furnished by the taxpayers in the GST returns information and provide such reports to the Centre and States;
- g) To analyse and provide analysis of taxpayers' profile;
- h) To match reversal and reclaim of input tax credit ; and
- i) To ensure data privacy and protection along with developing data retrieval and audit trails and other value added service.

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## 6. IMPORTANT DEFINITIONS

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The legislative framework for levy of GST is provided by the CGST Act, 2017 supported by other Acts, which have, by and large similar provisions. Hence some important definitions given by the CGST Act, 2017 are taken up below. Any reference to the sections, unless otherwise stated refer to the section of CGST, Act, 2017.

### (1) Business

As per section 2(17), “business” includes—

- (a) Any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit;
- (b) Any activity or transaction in connection with or incidental or ancillary to sub-clause (a); (c) any activity or transaction in the nature of sub-clause (a), whether or not there is volume, frequency, continuity or regularity of such transaction;
- (d) Supply or acquisition of goods including capital goods and services in connection with commencement or closure of business;
- (e) Provision by a club, association, society, or any such body (for a subscription or any other consideration) of the facilities or benefits to its members;
- (f) Admission, for a consideration, of persons to any premises;



- (g) Services supplied by a person as the holder of an office which has been accepted by him in the course or furtherance of his trade, profession or vocation;
- (h) Services provided by a race club by way of totalisator or a licence to book maker in such club; and
- (i) Any activity or transaction undertaken by the Central Government, a State Government or any local authority in which they are engaged as public authorities;"

From the above definition it can be noted that Business includes

- (a) Normal commercial activities like, trade, commerce, manufacture, profession, vocation, adventure:
- (b) Any activity carried out by a person whether or not, there is volume, frequency, continuity or regularity of such transaction. Any occasional or seasonal or a single transaction may constitute business.
- (c) Wager or betting, membership of clubs, societies, services of bookies at a race course, holding of an office, admission fees for housing societies etc.
- (d) Activities of non- profit organisations or activities not for pecuniary or monetary benefit. Accordingly, activities of providing meals by a charitable institution at concessional rates will be a business within the meaning of this section.
- (e) Any activity or transaction undertaken by the Central Government, a State Government or any local authority in which they are engaged as public authorities;" e. g. Registrar of companies, Indian Railways etc.
- (f) All other activities incidental or ancillary to the aforesaid activities,

**Illustrations of business :**

- (a) Banks providing financial services to its customers.
- (b) Company manufacturing articles for sale.
- (c) Consultancy by a chartered accountant
- (d) Acting in films
- (e) Gambling or betting
- (f) Hospital providing free medicines
- (g) Locker service provided by banks
- (h) Telecom services
- (i) Sale of Cinema tickets
- (j) Membership fees of recreation club etc.

## (2) Consideration

As per section 2(31), “consideration” in relation to the supply of goods or services or both includes—

(a) Any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;

(b) The monetary value of any act or forbearance, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government:

Provided that a deposit given in respect of the supply of goods or services or both shall not be considered as payment made for such supply unless the supplier applies such deposit as consideration for the said supply;

On a reading of the definition of “consideration”, which also an inclusive one, Following important points need attention :-

- (a) Consideration must have a direct nexus with supply of goods or services or both.
- (b) Consideration can be in monetary or non-monetary form or partly in monetary form and partly in non-monetary form.
  - Monetary consideration includes payment by cash, cheque or credit card, bank transfer and deduction from bank account.
  - Non-monetary consideration essentially means compensation in kind such as:
    - Supply of goods and services
    - Refraining or forbearing to do an act
    - Tolerating an act or a situation
    - Doing or agreeing to do an act

(c) Consideration implies a contractual relationship between the two parties, where a person does something in consideration or exchange of something done by the other person. Consideration includes the reciprocal promises in relation to the supply of goods or services or both in normal commercial parlance.

### Example:

1. A's car is marooned in muck and the passers by help him pushing the car out of muck without any contractual obligation. This will not be consideration because there is no reciprocity by contract although A may pay them some money.

2. A repairs the car of his lawyer, who fights his case in a court of law. A's services and the lawyers' services will form reciprocal promises or consideration for each other,
- (d) Consideration may be past, present or future. A receives an advance for submitting his project report. It is a case of consideration for service to be provided.
- (e) Consideration must be **in respect of, in response to, or for the inducement** of, the supply of goods or services or both. Promotional material or samples will form valid consideration as inducement for supply of goods or services.

### Example

A highway hotel provides free meal to drivers and other staff members of the bus, if they stop buses full of passengers at their hotel. The monetary value of the meals will be the consideration by way of inducement as it is directly linked in relation to meals provided to passengers.

- (f) Consideration may come from the by the recipient of the supplies or by any other person. E.g. IPL books a hotel rooms for the participating cricket team. In this case hotel provides services to the players bur consideration follows from the IPL.
- (g) Consideration does not include any subsidy given by the Central Government or a State Government e.g. cash assistance to exporters will not be consideration;
- (h) The monetary value of any act or forbearance shall be the value of consideration.
- (i) A deposit given for supply of goods or services shall not be considered as consideration unless the deposit is adjusted towards the consideration.

E.G. A hotel takes a deposit from its client for booking of rooms. Such deposit will not be deemed consideration unless it is appropriated towards the room tariff.

### (3) Electronic Commerce Operator

As per section 2(45) "electronic commerce operator" means any person who owns, operates or manages digital or electronic facility or platform for electronic commerce;

Electronic commerce" as per section 2(44) means the supply of goods or services or both, including digital products over digital or electronic network, Snapdeal, Flipkart, Amazon, Shopcluse etc., who own portal for e commerce on behalf of different suppliers will be covered in the definition of electronic commerce operator. There

are special provisions for compulsory registration TDS/ TCS etc. by the electronic commerce operators.

#### **(4) Goods**

As per section 2(52) “goods” means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply;

As per the definition :

a) goods include

- every kind of movable property,
- actionable claims and
- Growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply.

b) Goods do not include money and securities (shares, debentures etc.)

c) Although actionable claims are goods u/s 2 (52), in view of Schedule III and section 7, actionable claims other than lottery, betting and gambling are transactions or activities shall not be treated as supply of goods or services. Only lottery, betting and gambling shall be treated as supplies chargeable to GST not other actionable claims.

#### **(5) India**

As per section 2(56), “India” means the territory of India as referred to in article 1 of the Constitution, its territorial waters, seabed and sub-soil underlying such waters, continental shelf, exclusive economic zone or any other maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976, and the air space above its territory and territorial waters;

#### **(6) Non- taxable Supply**

As per Section 2(78), “non-taxable supply” means a supply of goods or services or both which is not leviable to tax under this Act or under the Integrated Goods and Services Tax Act;

The Schedule III activities or transactions notified by Government under section 7(2) (b) of the CGST Act define the transactions which are neither considered as supply of goods nor supply of service. The activities described therein will not be chargeable to GST. Hence, they will be considered as a non-taxable supply.

Further, this definition has to be seen in the context of "Exempt supply" as defined in section 2(47), which means supply of any goods or services or both,

- Which attracts nil rate of tax, i.e. the goods or services are taxable but at Nil Rate.
- Supplies notified as wholly exempt u/s of CGST Act,
- Supplies exempt u/s section 6 of the IGST Act, or
- Non-taxable supply.

### **(7) Person**

As per section 2(84) "person" includes—

- a. an individual;
- b. a Hindu Undivided Family;
- c. a company;
- d. a firm;
- e. a Limited Liability Partnership;
- f. an association of persons or a body of individuals, whether incorporated or not, in India or outside India;
- g. any corporation established by or under any Central Act, State Act or Provincial Act or a Government company as defined in section 2 (45) of the Companies Act, 2013;
- h. any body corporate incorporated by or under the laws of a country outside India;
- i. a co-operative society registered under any law relating to co-operative societies;
- j. a local authority;
- k. Central Government or a State Government;
- l. society as defined under the Societies Registration Act, 1860;
- m. trust; and
- n. every artificial juridical person, not falling within any of the above;

The definition of person is elaborate and gives a broad list of 14 entities including persons, firms LLP, companies, governments, societies and Trusts

### **(8) Principal Supply**

As per section 2(78) "principal supply" means the supply of goods or services which constitutes the predominant element of a

composite supply and to which any other supply forming part of that composite supply is ancillary.

This definition is to be seen in the context of the following two definitions:

“Composite supply” (section 2(27)) “a supply made by a taxable person to a recipient comprising two or more supplies of goods or services, or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply.

### **Illustration**

Where goods are packed and transported with insurance, the supply of goods, packing materials, transport and insurance is a composite supply and supply of goods is the principal supply.

“Mixed supply” (section 2(66)), means “two or more individual supplies of goods or services, or any combination thereof, made in conjunction with each other by a taxable person for a single price where such supply does not constitute a composite supply.

### **Illustration**

A supply of a package consisting of canned foods, sweets, chocolates, cakes, dry fruits, aerated drink and fruit juices when supplied for a single price is a mixed supply. Each of these items can be supplied separately and is not dependent on any other. It shall not be a mixed supply if these items are supplied separately.

## **(9) Recipient**

U/s 2(93), “recipient” of supply of goods or services or both, means -

- (a) Where a consideration is payable for the supply of goods or services or both, the person who is liable to pay that consideration;
- (b) Where no consideration is payable for the supply of goods, the person to whom the goods are delivered or made available, or to whom possession or use of the goods is given or made available; and
- (c) Where no consideration is payable for the supply of a service, the person to whom the service is rendered, any reference to a person to whom a supply is made shall be construed as a reference to the recipient of the supply and shall include an agent acting as such on behalf of the recipient in relation to the goods or services or both supplied;

The definition gives the three different situations to determine the recipient :

- (a) When the consideration is payable for the supply of goods or service, the person who pays the consideration will be the recipient. E.g. A sells a watch to B for Rs. 2,000. B is the recipient because he pays the consideration of Rs 2000 for the watch.
- (b) Where no consideration is payable for the supply of goods, the person whom the goods are delivered will be the recipient. E.G. A donates the watch to B a charitable trust. B will be the recipient.
- (c) In case of service provided without consideration, the person to whom the services are provided will be the recipient. E.G. A files return of income for B free. B will be the recipient of service.

**(10) Reverse charge**

As per section 2(98) “reverse charge” means the liability to pay tax by the recipient of supply of goods or services or both instead of the supplier of such goods or services or both u/s 9(3) or 9(4) or us 5 (3) or 5(4) of IGST Act, 2017.

Reverse Charge Mechanism (RCM) means that the GST is to be paid and deposited with the Government by the recipient, not by the supplier of goods or services or both. RCM will be applicable only in two circumstances :

- a) Under section 9(4), registered person being the recipient of intra-state taxable supply goods or services or both from any unregistered supplier. This provision is presently kept in abeyance. RCM will not be applicable in respect of transaction of exempted supply of goods or services from an unregistered supplier and inter-state transactions. Reverse Charge provisions would not be applicable if the aggregate value of such supplies of goods or services or both received by a taxable person from any or all the suppliers, who are not registered, does not exceed Rs. 7,500 in a day.

**Illustrations:**

- 1. A stays in a hotel with tariff of less than Rs. 1,000 per day, this being exempt supply RCM will not be applicable.
- 2. A Ltd. pays maintenance charges to the co-operative housing, which are less than Rs. 5,000, again will not be hit by RCM as this will be an exempted supply.
- 3. A taxable person pays room tariff of Rs 10,000 per day for stay in an unregistered hotel, A will have to pay GST o under the RCM.

- b) U/s 9(3), reverse charge will be applicable on the recipient of specified goods and services inter-state or intra-state both.

**Notified goods :-**

- a. Items supplied by agriculturist to a registered person ;
  - i. Cashew nuts, not shelled or peeled Agriculturist
  - ii. Bidi wrapper leaves (tendu)
  - iii. Tobacco Leaves
- b. Silk Yarn supplied by any person who manufactures silk yarn from raw silk worm cocoons for supply of silk yarn to any registered person
- c. Supply of lottery tickets state or Central/ State Govt. local authority to lottery distributor or selling agent.

**Notified Services -**

1. Services provided through an e-commerce operator, reverse charge shall be on the e-commerce operator.
2. Other notified services.
  - a. Any service supplied by any person who is located in a non-taxable territory to a person in taxable territory
  - b. Supply of Services by a Goods Transport Agency (GTA) to –
    - i. Any factory registered under or governed by the Factories Act 1948, or
    - ii. Any society registered under the Societies Registration Act, 1860 or under any other law for the time being in force in any part of India, or –
    - iii. Any co-operative society established by or under any law, or
    - iv. Any person registered under CGST Act or SGST Act or IGST Act or UTGST Act, or
    - v. Any body corporate established, by or under any law, or
    - vi. Any partnership firm whether registered or not under any law including association of persons, or
    - vii. Any Casual taxable person located in the taxable territory.
  - c. Legal services for representing before any Court, Tribunal or Authority, provided by any individual advocate including a senior advocate or firm of advocates to any business entity located in the taxable territory.
  - d. Services provided by an Arbitral Tribunal to a business entity located in the taxable territory.
  - e. Sponsorship Service provided by any person to a body corporate or partnership firm located in the taxable territory



- f. Services provided by the Govt., or Local Authority excluding Central Govt., State Govt., Union Territory or any Business entity located in the taxable territory except the following services
  - i. Services by the Department of Posts by way of Speed Post, express parcel post, life insurance, and agency services provided to a person other than Central Govt., State Govt., or Union Territory or Local Authority.
  - ii. Services in relation to an aircraft or a vessel, inside or outside the precincts of an airport or a port -Transport of Goods or Passengers Local Authority.
- g) Renting of Immovable Property, by director of a Company or a body corporate to the company or the body corporate.
- h) Services provided or agreed to be provided by an Insurance Agent to any person carrying on the Insurance Business.
- i) Services provided or agreed to be provided by a recovery agent a recovery agent a banking company or a financial institution or a NBFC
- j) Services supplied by a person located in non-taxable territory by way of transportation of goods by a vessel from a place outside India up to customs station of clearance in India to a person (importer) located in taxable territory.
- k) Supply of services by an author, music composer, photographer, artist etc. By way of transfer or permitting the use of a copyright covered under Section 13(1) (a) of the Copyright Act 1957 to a music company or producer etc.

#### **Other relevant points**

1. Persons covered by RCM will have obtained compulsory registration under GST.
2. GST under RCM is to be deposited by the 20th of the next month.
3. GST paid under the Reverse Charge Mechanism would be available for Input Tax Credit if such goods/ service are used in the furtherance of business by the recipient.
4. The details of GST paid under RCM are to be manually furnished as they will not be auto-populated in the GSTR 2.
5. In cases where RCM is levied, the recipient shall raise an Invoice on self. Invoice shall be issued on a daily basis for all consolidated purchases made during the day on which GST is levied under Reverse Charge. [Section 31(3)(f)]
6. At the time of payment to the supplier, the recipient shall also issue a payment voucher for the payment made.

7. Input Tax Credit with the recipient cannot be used for payment of Reverse Charge to the Govt.
8. A registered person will not lose input tax credit of GST paid under Reverse Charge even if the payment is not made within 180 days.
9. Reverse Charge is also applicable to recipients registered under the Composition Scheme. No Credit of RCM is available in such cases.
10. RCM is levied on advance payments as well.
11. Time of supply of goods means (a) the date of receipt of goods, (b) the date of payment or (c) the date immediately after 30 days from the date of issue of invoice by the supplier, whichever is earliest or the date of entry in the books of accounts of the recipient, if the three dates above cannot be determined.
12. Time of supply of services means the date of payment, or the date immediately after 60 days from the date of issue of invoice by the supplier, whichever is earlier, or the date of entry in the books of account, if both the dates are not available.
13. Date of Payment for the purpose of computation of date of supply, shall be the date on which the payment is debited from his bank account or the date on which the recipient entered the payment in his books, whichever is earlier.

### **Illustrations**

1. If goods were received on January 1, invoice was raised February 1 and payment was made on March 31, date of supply will be January 1, earliest of the three, if all the three dates are not available, February 1 being the date of making entry in books of account will be the date of supply.
2. If invoice was raised in respect of supply of service on June 1, and the payment was made on August 1, date of supply will be June 1 the earliest date. If both the dates are not available, it will be date of entry on books of account

### **(11) Services**

As per section 2(102) "services" means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged;

As per the definition of service will not include goods, money and securities. Goods is separately taxable, but money and securities are outside the ambit of GST and are excluded from the definition of goods and services both.

However, services will include activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged.

If no separate consideration is charged, then it will not be included in services.

**Examples :**

1. A buys a demand draft but depositing cash plus DD charges. Cash deposit will be money transaction not liable to GST but DD charges will be services liable to GST.
2. A change his currency notes into notes of small denomination. If there is no charge for the conversion it will not be service. If there is any conversion charge, they will be service liable to GST.

**(12) Supplier**

As per section 2(105) "supplier" in relation to any goods or services or both, shall mean the person supplying the said goods or services or both and shall include an agent acting as such on behalf of such supplier in relation to the goods or services or both supplied.

**Supplier includes**

- A person who supplies goods or services or both on his own behalf , or
- An agent acting as such on behalf of such supplier.

Hence, an agent has been included in the definition of supplier.

**(13) Taxable Person**

As per section 2(107) "taxable person" means a person who is registered or liable to be registered under section 22 or section 24;

As per the section a taxable person will include the following:-

- A person who is registered.
- Person liable to be registered mandatorily e.g. casual taxable person).
- Person liable to be registered provided aggregate turnover of supply of goods or services or both exceeds threshold limit of Rs 20 lakh/10 lakh.

**(14) Taxable Supply**

As per Section 2(108) “taxable supply” means a supply of goods or services or both which is leviable to tax under this Act;

A zero rated supply is also a taxable supply u/s 2(105) with tax rate being zero.

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**13. SELF-EXAMINATION QUESTIONS**


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- 1) Explain the concept of GST.
- 2) List the Central and State levies which will be subsumed in GST in India.
- 3) What are the taxes not subsumed in GST
- 4) Enumerate and explain the principles for subsuming taxes in GST.
- 5) Explain the benefits and need for GST.
- 6) Explain the dual GST model to be introduced in India.
- 7) Ascertain GST on a product sold at a MRP of 20,000 rupees inclusive of 10% GST. A has A has purchased this product for Rs. 15,000?

*(Ans. GST -  $20,000 \times 10/110$  Rs 1818, Input credit  $15,000 \times 10/110 =$  Rs 1364, payable Rs 1818-1364 = Rs 454)*

- 8) What it reverse charge?
- 9) Multiple Choice questions ;
  - A. Which of the following taxes have been subsumed in GST?
    - (a) Central Sales Tax (b) Central Excise Duty (c) VAT (d) All of the above
  - B. Functions of Goods and Services Network (GSTN) include:
    - (a) Facilitating registration (b) forwarding the returns to Central and State authorities (c) computation and settlement of IGST (d) All of the above
  - C. GST is levied on supply of all goods and services except:
    - (a) Alcoholic liquor for human consumption (b) Tobacco (c) Health care services (d) All of the above
  - D. On Petroleum Crude, High Speed Diesel, Motor Spirit (Petrol), Natural Gas and Aviation Turbine Fuel:
    - (a) GST is not levied (b) GST to be levied from a notified date decided by GST Council (c) GST is levied, but exempt (d) None of the above.

(Answers : (A) c(B) a (C) b (D)c (E) (a) (F) b. (G (c),H (d), I(d),J (d),K (a), L(d))



## REGISTRATION UNDER GST

### Synopsis :

1. Introduction and Objectives
2. Need and Advantages OF Registration
3. Liability for Registration
4. Registration Procedures
5. Self- Examination Questions

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### 1. INTRODUCTION AND OBJECTIVES

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The GST is a destination-based tax levied on the actual consumer of the goods and services or both. The consumer bears the burden of GST. The liability for payment of tax to the Government is on the supplier of goods or service. Consequently, actual and factual taxpayers are different persons.

Registration establishes a chain between the Government and the consumer. It helps the Government to identify the taxpayers and enables the taxpayers to collect tax from the consumers. Further, it establishes a seamless flow for claiming credit of tax paid on inputs (ITC).

This lesson takes a detailed look at the provisions relating to Registration, its need, advantages, liability for registration, exemption from registration, procedural aspect for registration and its modification or cancellation etc.

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### 2. NEED AND ADVANTAGES OF REGISTRATION

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Registration is a process for obtaining a unique number from the Government by a supplier of goods or service or both. It enables or authorises the supplier to collect tax from the consumer of goods or services or both on behalf of the Government and avail Input tax credit for the taxes on his inward supplies.

Without registration, a supplier cannot collect tax from his customers nor can he claim any input tax credit of tax paid by him.

Registration confers the following advantages on a taxpayer:-

- a. Registration grants official recognition to a person as the supplier of goods or services or both.
- b. Only a registered supplier is authorised to collect tax from the consumers.
- c. The supplier may pass on credit to in respect of the taxes paid on the goods or services or both, supplied to the consumers.
- d. The supplier may claim and utilise input tax credit of taxes paid towards the discharge of his liability for taxes due on supply of goods or services or both.
- e. Registration establishes a supply chain at the national level with a seamless flow of Input tax credit from the suppliers to the consumers.

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### **3. LIABILITY FOR REGISTRATION**

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Liability for registration is co-extensive with the liability to pay GST, which arises on happening of the taxable event viz. the taxable “supply” of goods or service or both; by a supplier thereof. A supplier is liable for registration in four ways, viz.:-

- a. Migration of the existing taxpayer from the old law to the GST,
- b. Registration based on minimum turnover of supply of goods or services or both,
- c. Compulsory registration irrespective of the turnover limit, and
- d. Voluntary registration irrespective of the turnover limit.

#### **a. Migration of the existing taxpayer from the old law to the GST**

As a transitory measure, every taxpayer registered or holding a license under any of the existing laws, central excise, service tax or VAT etc. was required to obtain provisional registration to migrate to the GST by 30th June 2017 i.e. a day before the appointed day 01 July, 2017, when GST came into effect as required under section 22(2) of the CGST Act, 2017.

The registration process was very simple and online migration to GST was possible. However, the registration was only provisional and was subject to final registration upon submissions of requisite documents and information. Also there were elaborate provisions for declaration of stocks and unavailed input credit on 30th June 2017 to facilitate smooth transition to the new regime.

#### **b. Registration based on turnover of taxable supply**

Section 22(1) of the Central Goods and Services ( CGST) Act, 2017, provides that every supplier , whose aggregate turnover of taxable supply of goods or services or both exceeds the threshold limit during a financial year, is liable for registration in the

State or Union Territory, from where he makes a taxable supply of goods or services or both.

The threshold or the specified limit of aggregate turnover is :-

- Ten lakh rupees in special category states( other than Jammu and Kashmir); and
- Twenty lakh rupees in all the other states including Jammu and Kashmir.

**Special category** states are Arunachal Pradesh, Assam, Jammu & Kashmir Manipur, Meghalaya, Mizoram Nagaland and Tripura and Himachal Pradesh, Sikkim and Uttarakhand. Jammu & Kashmir, although being a special category state has opted for threshold limit of Rs 20 lakh.

### **Aggregate turnover**

A. “Aggregate turnover” as per section 2(6), means the aggregate value of-

- i. All taxable supplies,
- ii. Exempt supplies,
- iii. Exports of goods or services or both, and
- iv. Inter-State supplies

B. Aggregate turnover of supply of goods or services or both is computed :-

- a. for a supplier having the same Permanent Account Number, on the principle of one PAN- one person,
- b. for the whole of India taken together,
- c. with reference to a financial year i.e. April to March

C. The value of aggregate turnover *excludes*:-

- a. Central tax, State tax, Union territory tax, Integrated tax and Cess;
- b. The value of inward supplies on which tax is payable by a person on reverse charge basis;

D. Vide explanation to the section 22 , the aggregate turnover includes:-

- a. all supplies made by the taxable person on his own account ; or
- b. supplies made on behalf of all his principals; or
- c. in case of a principal, the supply of goods by a registered job worker after
- d. completion of job-work,

**Persons not liable for registration-Section 23**

Following persons are not liable for registration vide Section 23 :-

- A. Any person engaged exclusively in the business of supplying goods or services or both; that are not liable to tax or wholly exempt from tax under the CGST Act or the IGST Act;
- B. An agriculturist, to the extent of supply of produce out of cultivation of land
- C. Any class of persons specified by the Government on the recommendations of the Council, by notification. Under this section, the government has granted exemption from registration under this section, to :
  - (i) Individual advocates including senior advocates ,
  - (ii) Individual sponsorship service providers including players ,
  - (iii) *Suppliers, whose all supplies are taxable under reverse charge (vide Notification No. 5/2017-Central Tax dated 19.06.2017).*

**Some relevant points**

- a. The liability for registration is on “every supplier”.
- b. The supplier should make a taxable supply of (i) goods or (ii) services or (iii) both over the threshold limit of 10 lakh/20 lakh rupees.
- c. Under section 22 read with section 23, a supplier of only tax-free supplies is not liable for registration but if he some taxable supply, then, all supplies, whether taxable or tax-free in the course of export or inter-State supply, will be considered in aggregate turnover.
- d. Registration will in the state or union territory, from where the supplier makes the taxable supply of goods or services or both.
- e. An agriculturist is specifically exempted from registration to the extent of supply of produce out of cultivation of land the supply even if exceeds the threshold limit.
- f. Similarly a supplier of only supplies taxable under reverse charge, is also exempted from registration vide Notification No. 5/2017-Central Tax dated 19.06.2017.
- g. All supplies by a taxable person will be included in his aggregate turnover whether made
  - On his own account; or
  - As an agent on behalf of all his principals; or
  - In case of a principal, the supply of goods, after completion of job-work, by a registered job worker.



- h. The value of the supply considered in the account of the principal, shall not be included in the aggregate turnover of the registered job worker because only one person should be liable for accounting the turnover of supply.

### 3.2.5. Illustrations:

1. A supplies taxable goods from Imphal (Manipur). He will be liable for registration u/s 22, when the value of services provided by him exceeds Rs. 10 lakh applicable to the state of Manipur, a special category state.
2. B provides taxable service in Panaji (Goa) to a Kolkata based wholesaler in tea. He will be liable for registration in Panaji when the aggregate turnover or supply (sales) exceeds Rs. 20 lakh.
3. A is an agent for his principal B. A supplies (sells) taxable goods of Rs. 15 lakh on his account and Rs. 7 lakh on B's Account. A will be liable for registration, when the turnover exceeds Rs. 20 lakh inclusive of supply made on his account and on B's account.
4. X is a jeweller based in Pune. He sends goods on job work to the registered artisan, who completes the job work and sends goods to X valued at Rs. 14 lakh. X's own turnover is of Rs. 8 lakh. A will be liable for registration on his own turnover and the goods received from the job worker, when the turnover exceeds the threshold limit of Rs. 20 lakh. However, then the turnover of Rs. 14 lakh will be excluded from the turnover of the job worker.
5. An educational institution which provides tax-free education services valued at Rs 50 lakh, will not be liable for registration u/s 23 because it does not provide any taxable supply.
6. A hospital provides tax-free medical services of Rs 18 lakh and taxable services of Rs. 4 lakh. It will be liable because its aggregate turnover exceeds Rs. 20 lakh.
7. A makes export of taxable goods for Rs. 100 lakh. A will be liable for registration, although his tax liability will be nil.
8. A is engaged exclusively in supplying tax-free goods. He is not liable for registration under this clause even if the turnover exceeds the limit of Rs 20 lakh.
9. Turnover of B from supplying exempted goods is Rs. 50 lakh and on supplying taxable goods is Rs. 25 lakh. B will be liable for registration from the date on which the aggregate turnover of supply of goods exceeds Rs. 20 lakhs.

### c. **Compulsory registration**– section 24

As per Section 24 of the CGST Act, 2017, following categories of persons are liable for compulsory registration under

section 24 of the CGST Act, 2017, irrespective of the amount of turnover:-

**(i) Inter-State Suppliers**

Persons making any inter-State taxable supply (e.g. from Chennai to Pune); However, vide Notification No. 10/2017-Integrated Tax dated 13.10.2017, the benefit of threshold limit of 10 /20 lakhs has been extended to persons making inter-State supplies of taxable services, having an aggregate turnover, to be computed on all India basis, not exceeding an amount of twenty lakh rupees (ten lakh rupees for special category States except J & K) and such persons will be exempted from obtaining registration

**(ii) Casual taxable persons**

A casual taxable person means a person, who has a registered business in a Union Territory and wants to effect taxable supplies from some other State or Union Territory where he is not having any fixed place of business. Such persons are liable for registration in the State from where they seek to effect a taxable supply as a casual taxable person.

A casual taxable person has to obtain registration at least five days in advance of making such supply and make advance deposit of the estimated tax liability. Further such registration granted only for a specified period only, not exceeding 90 days but which may be extended on making application.

However, a casual taxable person making supplies of specified handicraft goods will be entitled to the threshold exemption of Rs. 20 Lakh / 10 lakh and need not take compulsory registration.

**(iii) Non-Resident Taxable Persons**

Non-resident taxable person means a foreigner not having fixed place of business in India and who desires to make any taxable supply any State in India.

Has to compulsorily apply for registration such persons at least five days in advance of making such supply and also make advance deposit of the estimated tax liability. Registration is granted to the non-resident taxable persons only for a specified period only, but the period may be extended on making application.

**(iv) Payers of tax under reverse charge**

The persons who are required to pay tax under reverse charge on the supplies received by them. e.g. clients of advocates, those receiving transport services from a goods transport agency etc.

**(v) E-Commerce Operators**

E-commerce operators, notified as liable for GST payment under section 9(5) of the CGST Act, 2017,

**(vi) Tax Deductor;**

Persons required deducting tax under section 51, whether or not separately registered under this Act;

**(vii) Agents**

Persons making taxable supply of goods or services or both on behalf of other taxable persons whether as an agent or otherwise;

**(viii) Input Service Distributors**, whether or not separately registered under this Act;

**(ix) Suppliers through E-Commerce Operator subject to TCS**

Persons who supply goods or services or both, other than supplies specified under section 9(5) through such E - Commerce Operator who are required to collect tax at source (TCS) under section 52;

**(x) Supplier through E-Commerce Operators subject to TDS**

Suppliers of goods who supply through such E-Commerce Operators, who are liable to collect tax at source. However, suppliers of taxable service through e-commerce operators need not take compulsory registration and are entitled to avail the threshold exemption of Rs. 20 lakh/10 lakh (Notification No. 65/2017-Central tax dt. 15.11.2017)

**(xi) E-commerce Operators**, who provide platform to the suppliers to make supply through them.

**(xii)** Every person supplying Online Information and Database Access or Retrieval Services (OIDAR) from a place outside India to an unregistered person in India;

**(xiii)** Such other person or class of persons as may be notified by the Government on the recommendations of the Council.

**d. Voluntary registration**

Any person having turnover below the threshold limit can apply for voluntary registration. Such a person will not get the benefit of the threshold limit of Rs 20 lakh /10 lakh entire turnovers will be subject to GST from the day of registration further a voluntary registration will not be cancelled until one year from the date of registration.

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## 4. REGISTRATION PROCEDURES

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There are different procedures for registration for a non-resident taxable person, casual taxable persons, deductors of tax, collectors of tax and supplier of Online Information Database Access and Retrieval (OIDAR) services and other suppliers. Some relevant provisions have been dealt with separately at the appropriate places. For all other suppliers the following will be the procedure for registration.

### 4.1. Nature of Registration

- (i) Registration under GST is not tax specific. There will be a common registration for all the taxes i.e. CGST, SGST/UTGST, IGST and Cesses.
- (ii) Registration under GST is PAN based and State specific. A given PAN based legal entity would have one GSTIN per State. It would mean:-
  - i. A taxable person is required to register in each State or Union territory from where he effects supply. Hence, an entity having branches in multiple States will have to take separate State wise registration for the branches in different States.
  - ii. If the branches of the entity are within one State or Union territory, it can have single registration declaring one place as the principal place of business and other as the branches as additional place of business.
  - iii. The above rule subject to the following three exceptions , where separate registration is required even within a state :
    - a) a unit in SEZ ; or
    - b) a SEZ developer;or
    - c) Each of business verticals separately of business entity within a State or Unit Territory. Section 2(18) of CGST Act, 2017 defines business vertical as under:

“Business vertical means a distinguishable component of an enterprise that is engaged in supplying an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business verticals;

**Explanation:** Factors that should be considered in determining whether products or services are related include:

- (a) The nature of the products or services;
- (b) The nature of the production processes;
- (c) The type or class of customers for the products or services;

- (d) The methods used to distribute the products or provide the services; and
- (e) If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.”
- iv. Upon registration each supplier is allotted 15-digit ‘ Goods and Service Tax Identification Number or “GSTIN” comprising of the first 2 digits for the State code followed by 10 digits PAN of the legal entity, 2 digits for the entity code and the last digit for check number.
- v. A centralised unique identification number (UIN) is issued in respect of supplies to some notified agencies of United Nations organisation, multinational financial institutions and other organisations.
- vi. Upon Registration a certificate of registration incorporating the GSTIN is issued to the taxpayer and the GSTIN is made available to the applicant on the GSTN common portal.

#### **4.2. Standardisation of procedures for Registration**

The GST registration rules prescribe as many as 30 standard forms / formats to be used for every process in the registration chain such as application for registration, acknowledgment, query, rejection, registration certificate, show cause notice for cancellation, reply, cancellation, amendment, field visit report etc., This is to ensure uniformity of the process all over the country and speeding up the decision making process. Further, the rules stipulate strict timelines for completion of different stages of registration process. The standardized process for registration is given below.

#### **I. Procedure for Registration Regular Taxpayers**

##### **A. Submission of application for registration**

- (i) Every taxable person, who is not a non-resident, deductor of tax and collector of tax has to submit application for registration online through the common portal (GSTN) or the Facilitation Centre in form GST REG-01.
- (ii) Time limit for submission of application is within thirty days from the date when liability to register arises.
- (iii) Form for GST REG-01 is in two part – Part A and part B
  - (i) Part-'A' – contains the applicant entity's name PAN, Mobile, email etc.
  - (ii) Part-B application reference no. given in acknowledgment in GST-REG-02
- (iv) Following documents are required for GST registration :-
  - (i) PAN of the applicant
  - (ii) Identify and address proof of the promoters

- (iii) Proof of registration of business, e.g. partnership deed, registration certificate, certificate of incorporation etc.
- (iv) Address proof for place of business such as Rent receipt, electricity bill, Municipal certificate etc.
- (v) Bank account proof
- (vi) Digital Signature
- (v) On submission of the application, PAN of the applicant is verified through GST portal Mobile no. and PAN through One Time Password (OTP) and if these documents are found to be in order, an acknowledgment will be issued in Form GST-REG-02 electronically.

### **B. Verification process**

- (i) The application will be forwarded to the proper officer of the respective State or the Central Government, who shall examine the application and the accompanied documents and after the verification, the proper officer shall approve and grant the registration within three working days.
- (ii) Where, the proper officer finds the application to be deficient for any reason or requires any further clarification, he shall intimate to the applicant in form GST-REG-03.
- (iii) The applicant shall submit the reply with clarification in form GST-REG-04 within seven working days starting from the fourth day of filing the original application/ the date of receipt of such information in form GST-REG-03. The clarification includes modification or correction of particulars declared in the application for registration.

### **C. Grant or refusal of registration**

- (i) The proper officer would have to grant the application for registration within seven working days thereafter and
  - a) Issue Registration Certificate in form GST-REG-06 ;r or
  - b) Reject the application in form GST-REG-05.
- (ii) If the proper officer does not respond within 3 working days of receipt of application or within 7 working days from receipt of clarification, then application under this Act shall be deemed to have been approved.

### **D. Physical verification in connection with registration**

The basic premise of the GST is reduction of physical interface and evolve a technology based tax regime. Hence, physical verification is avoided. However, where the proper officer is satisfied and deems necessity or desirable to carry out physical verification, he may do so only after granting the registration. Further after the verification, he shall upload the verification report along with the supporting documents and photographs to on the common portal within fifteen working days.

## **II. Registration procedure for casual taxable persons**

(i) Registration under GST is compulsory for the casual taxable persons irrespective of the annual aggregate turnover. For this purpose

- A casual taxable person is a person who occasionally undertakes transactions involving supply of goods or services or both in the course or furtherance of business, whether as principal, agent or in any other capacity, in a State or a Union territory where he has no fixed place of business. Persons running temporary businesses like event management, business fairs or exhibitions or other seasonal businesses fall under casual taxable persons under GST. Casual taxable persons, unlike the regular taxable person do not have a fixed place of business located in a State or Union Territory where they supply of goods or services or both.

(ii) A Casual Taxable person shall make the application for GST registration in form GST REG-01 at least 5 days prior to the commencement of business.

### **(iii) Deposit for GST Registration**

A casual Taxable person can not opt for composition scheme. Instead, he will have to deposit an amount equivalent to the expected tax liability during the validity period of GST registration in advance for GST registration. For this purpose, a temporary reference number is generated for payment of GST deposit.

(iv) On paying the GST deposit, the electronic cash ledger of the taxpayer is credited, and GST registration certificate is released, which will be valid initially for a period specified in the application or 90 days, whichever is earlier.

(v) The period of registration may be extended for a further period of 90 days on making application in form -GST-REG-11 before the expiry of the original validity period of registration and amount of additional tax liability during the extended period will have to be made. Other procedures will be similar as those applicable *mutatis mutandis* to regular taxable persons.

### **(vi) Filing of returns:**

A registered a casual taxable person has to file the following monthly returns

- Form GSTR-1 on or before the 10<sup>th</sup> of the following month giving detail of the outward supplies of goods or service made by him
- Form GSTR-2 after the 10<sup>th</sup> but on or before the 15<sup>th</sup> of the following month giving detail of the inward supplies made by him

- Form GSTR-2 after the 15<sup>th</sup> but on or before the 20<sup>th</sup> of the following month showing the tax liability base on auto populated details of GSTR 1 & 2.
- There is no requirement for filing annual return by a casual taxable person.

(vii) Refund of Tax

After filing all the returns for the registration period, a refund may be claimed in GSTR 3 and allowed in respect of the excess tax paid by the casual taxable person.

### **III. Registration procedure for non- resident taxable persons**

A Non-resident taxable person means any person or business or not-for-profit organisation, who occasionally undertakes transactions involving supply of goods or services or both, whether as principal or agent or in any other capacity, but who has no fixed place of business or residence in India. Foreigners and foreign entities supplying goods or services to India will be non-resident taxable persons as per the GST. The procedure for registration by a non-resident taxable person is as follows:

(i) Registration under GST is compulsory for the casual taxable persons irrespective of the annual aggregate turnover or any other criteria. A non-resident taxable person shall identify a person in India to act as its authorised representative who shall be a person resident in India having a valid PAN.

(ii) Application for registration shall be submitted

- at least 5 days prior to the commencement of business in India,
- shall be in form GST REG-09, and
- signed by his authorized signatory having a valid PAN in India

(iii) the non-resident taxable person during the GST registration process must file the following documents :

- documents showing proof of principal place of business( rent receipt agreement , electricity bill etc. or consent letter from the owner of the premises)
- Identity proof of the non-resident taxable person- passport, visa etc.
- Tax identification number or unique number on the basis of which the entity is identified by the Government of that country or its PAN, if available.
- Authorisation for authorised representative in India along with the copy of the resolution of the board of directors granting such Authorisation, if any
- Certificate of incorporation of the company.



- License issued by foreign country, if any
- Clearance certificate issued by Government of India, if any
- Bank account proof with IFC Code MICR etc.

(iv) GST Deposit for non-resident taxable persons

Like the Casual taxable persons, non-resident taxable persons are also required to remit in advance a deposit equivalent to the expected tax liability during the validity of the registration for GST registration, where upon the registration certificate will be issued. Similar process is to be followed for extension of restoration period and additional deposit will be required to be made equivalent to the estimated tax liability for the extended period. An application reference number would be generated for payment of advance tax for obtaining GST registration and an allocation will have to be filed for extension of registration Period in for GST-REG-11.

(v) For final registration, an application is required to be submitted in form GST REG-26 electronically within a period of 3 months from the provisional registration. Other provisions are similar to those applicable on the regular taxable persons in regard to the final registration.

(vi) The proper officer, after verification shall issue registration in form GST REG-06.

(vii) If the officer is not satisfied with the correctness or completeness of the information submitted or needs additional information, he shall issue a show cause notice to the applicant in Form GST REG-27.

(viii) If the reply to the show cause is satisfactory, the show cause notice may be cancelled by issuing an order in Form GST REG-20, and if it is not satisfactory, then the officer after giving opportunity of being heard to the applicant may pass an order for cancellation of the provisional registration granted to the applicant in Form GST REG-28.

(ix) The rules for filing of returns, refunds etc. are similar to those applicable to the casual taxable persons.

#### **IV. OIDAR service providers**

A taxable person supplying online information and data base access or retrieval (OIDAR) services to a non-taxable online recipient shall file the application for registration in Form GST REG-10 electronically and follow the procedure applicable to non-taxable persons.

#### **V. Deductor or collector of GST**

A person who is liable to deduct GST at source or collect GST e.g. e-commerce operator will have to follow the normal

procedure as applicable except that application for registration shall be submitted electronically in Form GST REG-7

#### **VI. Special agency like United Nation Organization etc.**

United Nations and other connected specified agencies shall apply for registration in GST-REG-13. It may be noted that these agencies are not liable to GST under the international protocol, but registration will still be required to claim refund of taxes paid on inward supply of goods or service or both.

#### **VII. Succession or transfer of business**

The transferee of a business as going concern as result of succession or transfer of business as result of amalgamation, merger, demerger or change in constitution etc. is liable for registration within days from the date of transfer or succession and the transferee has to follow the applicable procedure as above.

### **4.3. Amendment of Registration**

Amendment in particulars of registration may be for the three reasons, viz. :

#### **(i) Change in core field**

Under Rule 12, a taxable person may make an application for amendment in Form GST -REG-14 within 15 days of the following changes, which do not require cancellation under section 29 of CGST Act:

- (i) legal name of the business, or
- (ii) the State of place of business or
- (iii) additional place of business., or
- (iv) names of the functionaries – like partners , directors , etc.

The proper officer shall after making necessary inquiry, approve the amendment electronically in form GST -REG-15 within next 15 days from the date of application.

#### **(ii) Change in Non- Core field**

All the other corrections amendments or change in the particulars of registration are called the change in non- core field. A taxable person *suo motu* (on his own) may effect the change on the common portal without seeking approval of the proper officer. This change includes a change in the name of the authorised signatory by adding another name of signatory. Otherwise the change will not be effective.

#### **(iii) Change in Mobile, email etc.**

Change in e mail, or mobile numbers may be effected in the common portal by the taxable person after an online verification through one time password (OTP) is issued.

**Eligible persons**

Change in the particulars can be effected by the following categories of persons, viz:

- (i) Applicant , Taxable person
- (ii) Person holding UIN Card or other notified person for registration under TDS/TCS U. N. bodies category,
- (iii) Non-Resident taxpayer
- (iv) GST Practitioner , and
- (v) Online application and retrieval service provider.

**Fields, which cannot be changed**

GST is State specific PAN based, hence the following changes which have the effect of changing these particulars is not allowed. e.g.

- a. PAN details
- b. Change in constitution of business ,
- c. Modification of place of business from one state to another.
- d. In these cases, a fresh registration will have to be obtained after cancelling the existing registration.

The amendments will come into effect from the date of application for amendment. However, the Commissioner may allow the amendments with retrospective effect.

**4.4. Cancellation of Registration**

**4.4.1** Under section 29(1), registration can be cancelled only in two circumstances :-

- (i) Voluntary cancellation when a taxable person no more requires it, or
- (ii) the proper officer considers the registration liable due to some specific defaults.

**4.4.2. Voluntary Cancellation :****a) Cancellation of registration of migrated taxpayers :**

A taxpayer, who has migrated from old tax to GST, may opt for cancellation

- on GSTN portal online, if he has not issued any tax invoice , or
- in Form GST- REG- 16 if his issued any tax invoice.

In either case, cancellation is allowed only for the following reasons :-

- a) turnover is below the threshold limit , or
- b) his supply is in exempted category.

## **b) Cancellation of registration of other taxpayers**

### **1. Time condition**

- (i) Where a taxable person not being liable for obtaining registration, has taken voluntary registration, cancellation of registration is not allowed until expiry of one year from the effective date of registration.
- (ii) Other taxpayer may opt for cancellation anytime as the condition of one year does not apply on them.

### **2. Reasons for cancellation**

The cancellation may be for the following reason:-

- a) the business of the taxpayer has been discontinued ; or
- b) the business has been sold or transferred to some other entity and that other entity needs to register under GST; or
- c) turnover is below the threshold limit , or
- d) the supply is in exempted category.

### **3. Procedure for cancellation**

A taxable person desirous of cancellation of registration may apply on the common portal within 30 days of event warranting cancellation in Form GST-REG-16. Such person is required to

- a) declare in the application the stock held on the date with effect from which he seeks cancellation ,
- b) work out and declare
  - the quantum of dues of payments,
  - credit reversal, and
  - the particulars of payments made towards discharge of such liabilities.

**4.** On receipt of the application the Proper officer shall cancel the registration within 30 days from the date of application or receipt of explanations or clarifications in response to his notice issued by him in Form GST-REG-16, if any. The notice has to be replied in Form GST-REG-18 within seven days. The order of cancellation in will be in Form GST-REG-19. Revocation of notice will be in Form GST-REG-20.

### **C. Suo-motu cancellation by the Officer**

The Proper Officer may issue a show cause notice in Form GST-REG-16 to a registered person and call for information and after considering such information and hearing the taxpayer, cancel the registration by passing an order in Form GST-REG-19, if he is satisfied that the registered person has :

- (i) contravened the provision of the Act and the Rules;
- (ii) furnished returns for-
  - a) three consecutive tax periods in case of a composition taxpayer, or
  - b) Continuous period of six month in case of a regular taxpayer;
- (iii) obtained voluntary registration but not commenced business within six months of registration;
- (iv) obtained registration by means of fraud , willful misstatement or suppression of facts;
- (v) discontinued business from the registered place of business;
- (vi) been issuing tax invoice without making the supply of goods or services; or
- (vii) Committed such other defaults as may be specified.

#### **4.5. Revocation of Cancellation**

Where registration is cancelled suo-motu, the taxable person, within a period of 30 days the service of cancellation order, may apply to the proper officer for revoking the cancellation order.

No such application shall be entertained unless the taxable person, before making such application, has made good the defaults by filing all pending returns, making payment of all dues etc. for which the registration was cancelled by the officer.

On receipt of the application, the Proper Officer, if satisfied, may wither revoke the cancellation earlier ordered by him or reject the request for revocation of cancellation, after observing the principle of natural justice by way of issuing notice to the person and hearing him on the issue.

#### **4.6. Cancellation not to affect pending tax liability :**

Cancellation of registration will not affect the liability of taxes prior to cancellation. Further, the taxpayer will have to pay his due taxes by reversing the input credit in stock (Raw materials, finished or semi -finished goods) or make payment, whichever is higher. Similarly, input credit on capital goods also will have to be reversed or the payment will have to be made.

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### **5. SELF EXAMINATION QUESTIONS**

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1. Explain the concept of casual taxable person.
2. What are the provisions for registration of a non- resident taxable person?

3. List out the forms used for registration and cancellation
4. State whether the following are true or false:
  - a) A migrated person cannot cancel his registration
  - b) Registration may be refused if turnover does not exceed the taxable limit
  - c) A farmer is not liable to GST in respect of his agriculture
  - d) A plastic surgeon, who provides life-saving surgery for Rs. 10lakh (exempt) and cosmetic surgery (taxable) for Rs. 12 lakh not liable for registration.
  - e) A charitable trust is not liable for registration under GST.
  - f) An advocate is liable for registration under GST.
  - g) A Jammu taxpayer with taxable turnover of Rs. 15 lakh not liable for registration.
  - h) Application for registrant in is to be made in GST-REG 1
  - i) A non- resident has to pay tax in advance
  - j) A GST number taken by fraud can be cancelled
  - k) A cancellation order cannot be revoked.

(False a, b, d, e, f and j, True c, g, h, i)



## TIME, PLACE AND VALUE OF SUPPLY

### Synopsis :

1. Introduction and Objective
2. Inter -State Vs. Intra-State Supply
3. Location of the Recipient of services
4. Location of the Supplier of services
5. Place of supply in respect of goods and services
6. Place of supply in respect of goods
7. Place of supply in case of supply of services, when location of the supplier and recipient is in India
8. Place of supply in case of supply of services, when location of the supplier and recipient is in India
9. Self- Examination Questions

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### 1. INTRODUCTION AND OBJECTIVE

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This lesson explains how each transaction has to pass through the threefold test of time, place and value of supply of goods and/ or services, which is essential to determine: -

- a. Whether tax is to be levied on a particular cross-border transaction;
- b. Whether a particular transaction it is an Inter-state supply or Intra-state supply;
- c. Who will collect the tax on such transaction;
- d. Type of the tax is be levied; IGST, CGST, or SGST/UTGST, on that transaction;
- e. The due date for depositing tax with the Government and for filing returns etc. and
- f. The amount of tax payable.

Further, the lesson will also explain the provisions relating to the place of supply of goods and their implications with reference to the location of the recipient of services and the location of the supplier of services.

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## 2. TIME OF SUPPLY

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Time of supply means the point in time, when the supply of goods and / or services takes place. Due date for payment of CGST / SGST / UTGST / IGST, is determined with reference to the time of supply of goods and/or services. Goods and services have a separate basis to identify their time of supply.

### A. Time of supply of goods.

Time of supply of goods will be the earliest of the following: -

1. Date of issue of invoice
2. Last date on which invoice should have been issued
3. Date of receipt of payment / Advance.

#### Illustrations:

- (1) Given: date of sales of goods 01 January, 2018, date of issuing invoice- 15th January, 2018. The payment received on 25<sup>th</sup> January, 2018. The goods delivered on 20<sup>th</sup> January 2018.

Time of supply is earliest of the following–

- (a) Date of issue of invoice = 15 January, 2018
- (b) Last date on which invoice should have been issued = 20<sup>th</sup> January 2018
- (c) Date of receipt of payment -25 January, 2018.

The time of supply will be 15 January, 2018.

- (2) Assuming, 50% payment received in advance on 01 January, 2018:
  - The time of supply for the advance amount (50%), will be 01 January, 2018 since the date of receipt of advance is before the date of issuing invoice.
  - For the balance 50%, the time of supply will be 15 January, 2018.

### B. Time of supply for services

Time of supply of goods will be the earliest of the following: -

- a. Date of issue of invoice (if issued within the prescribed time)
- b. Date of provision of services (if invoice is not issued within prescribed time.
- c. Date of receipt of payment /advance.

#### Illustrations:

- (1) Given – Date of providing service - 15 June 2018, Date of issuing invoice, 30 June, 2018, date of receipt of payment 20 July, 2018.



The time of supply will be earliest of the following: -

- a. Date of issue of invoice: 30 June, 2018
- b. Date of payment: 20 July, 2018

The time of supply of services will be 30 June, 2018.

(The invoice was issued on 30 June 2018 which is within the prescribed time, of 30 days from the date of provision of service 15 June 2018, i.e. 15<sup>th</sup> July 2018.)

- (2) Assuming the invoice was issued on 19th July, 2018, then the time of supply of services will be 15 June, 2018, being the date of providing service because the invoice is issued after the prescribed time of 30 days.

### **C. Time of supply of goods under reverse charge**

Time of supply of goods for the recipient of the service will be 30 days from date of issue of invoice for goods.

### **D. Time of supply of services under reverse charge**

Time of supply of goods for the recipient of the service will be 60 days from date of issue of invoice for goods.

- a. Date of payment:
- b. 60 days from date of issue of invoice for services

### **Illustrations :**

- (1) A company availed service of a lawyer to represent it before the ITAT on 15 May, 2018. The lawyer raised the invoice on 1 June, 2018. The Company made the payment on 1 July, 2018.

This is case of reverse charge in respect of service. The time of supply will be earliest of the following: -

1. Date of payment: 1 July, 2018
2. 60 days from date of date of invoice: 31 July, 2018

The time of supply of services is 1 July, 2018.

- (2) If the above was a case of supply of goods, then the time of supply of goods is 30 days from the date of invoice i.e. 1 July, 2018

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## **3. INTER-STATE SUPPLY VS INTRA-STATE SUPPLY**

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2.1 Broadly, the transactions may fall in two categories: -

A. International or cross border transactions, viz.:

- a. Imports of goods into India; or
- b. Export of goods outside India, and

B. Domestic transactions, viz:

- a. Inter-state supply
- b. intra-state supply

2.2. Inter-state supply is when “location of supplier” and “place of supply” are in different States or Union Territories (section 7 of the IGST Act). In contrast, intra-state supply is when “location of supplier” and “place of supply” are in the same state or same union territory (section 8 of the IGST Act).

### **Examples**

1. A supplier in Goa sells good in Goa. It is intra-state supply, liable to CGST and SGST as location of the supplier and the place of supply are within the same state (Goa).
2. The supplier in Daman (UT) sells goods in Goa. It is an inter-state supply attracting IGST as the location of the supplier and the place of supply fall in different states/UT.

While, Section 2(70) and 2(71) of CGST Act define “location of the recipient of services” and “location of the supplier of services” respectively, the Act does not define “location of the recipient of goods” and “location of the supplier of goods” at any place.

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## **4. “LOCATION OF THE RECIPIENT OF SERVICES**

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As per section, 2(70) of CGST Act “location of the recipient of services” means, —

- (a) Where a supply is received at a place of business for which the registration has been obtained, the location of such place of business;
- (b) Where a supply is received at a place other than the place of business for which registration has been obtained (a fixed establishment elsewhere), the location of such fixed establishment;
- (c) Where a supply is received at more than one establishment, whether the place of business or fixed establishment, the location of the establishment most directly concerned with the receipt of the supply; and
- (d) In absence of such places, the location of the usual place of residence of the recipient;

Thus, the location of the recipient primarily means: -

**A.**

Supply Received at	Location of Recipient of Service
Place of business for which the registration has been obtained	Recipient's Registered Office;
Place other than the place of business for which registration has been obtained, a fixed establishment	Recipient's fixed establishment
at more than one establishment, whether the place of business or fixed establishment	the location of the establishment most directly concerned with the receipt of the supply
in absence of such places	the location of the usual place of residence of the recipient;

**Illustration:**

A is registered at Fort, head office at Dadar and branches at Thane and Borivali. His residence is in Juhu.

For any supply received in Thane office, the place of recipient will be at:

1. Registered office at fort,
2. Dadar office, if A does not have registration at Fort; or
3. Most connected office at Thane (in absence of Fort and Dadar offices, and
4. Residence at Juhu, in absence of any of the above.

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## **5. "LOCATION OF THE SUPPLIER OF SERVICES"**

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U/s section 2(71), of the CGST Act, "location of the supplier of services" means: —

- (a) Where a supply is made from a place of business for which the registration has been obtained, the location of such place of business;
- (b) Where a supply is made from a place other than the place of business for which registration has been obtained (a fixed establishment elsewhere), the location of such fixed establishment;
- (c) Where a supply is made from more than one establishment, whether the place of business or fixed establishment, the location of the establishment most directly concerned with the provisions of the supply; and
- (d) In absence of such places, the location of the usual place of residence of the supplier;

The yardstick for determining the location of the provider or supplier of service are more or less similar to those applicable on location of the receiver of the supply.

Supply made from	Location of Supplier of Service
Place of business for which the registration has been obtained	Recipient's Registered Office;
Place other than the place of business for which registration has been obtained, a fixed establishment	Recipient's fixed establishment
at more than one establishment, whether the place of business or fixed establishment	the location of the establishment most directly concerned with the provision of the supply
in absence of such places	the location of the usual place of residence of the supplier

**Example:**

Goods are supplied to Surat Branch of Essar Shipping Limited. Its registered office is in Vashi, and the corporate office is in Mumbai. Place of supply will be Vashi, Mumbai and Surat in that order.

## **6. PLACE OF SUPPLY OF GOODS AND SERVICES**

Section 10 and section 12 of the IGST Act, 2017 lay down the principles for determination of place of supply broadly in three categories viz.: -

Section 10	Supply of goods
Section 12	Supply of services where location of both the supplier and the recipient is in India;
Section 13	Supply of services, where location of either the supplier or the recipient is outside India.

## **7. PLACE OF SUPPLY IN RESPECT OF GOODS**

Section 10 of the IGST Act, 2017, lays down the following principles to determine place of service of goods

### **4.1. When there is movement of goods**

When there is movement of goods, there may be two situations: -

**A.** Where supply involves movement of goods whether by the supplier or the recipient or by any other person, place of supply is

the place where the movement terminates i.e. where the goods are delivered or the ownership in goods is transferred.

### **Examples**

1. Paresh of Pen sells 100 cotton bales to Suresh of Satara. The place of supply is Satara in Maharashtra, where the movement of goods is terminated. Both Pen and Satara are in the state of Maharashtra, it is intra-State sales liable to CGST & SGST.
2. If Paresh sells goods to Bhupat of Bhopal in M.P., the place of supply will be in Bhopal M. P. M.P. and Maharashtra being different states; it will be inter-state sales attracting IGST.
3. Manoj of Mumbai places an order to Nokia's Chennai plant for purchase of mobile phones goods ex-factory.

Chennai will be the place of supply as the goods are delivered there. Both, the place of supply and location of the supplier being in same State Tamil Nadu, it will be intra-State sales chargeable to CGST and SGST. It is immaterial that Manoj, after collecting goods from the factory of Nokia, Chennai transports the goods to his place of business in Mumbai or anywhere else.

### **B. Delivery to a third party as per instructions**

When goods are delivered by a seller to the recipient (whether agent or not) on the direction of a buyer before or during the movement of goods, by way of transfer of document of title to the goods or otherwise, the place of supply will be the principal place of the buyer on the assumption that the buyer has received the goods.

### **Examples**

1. Jatin of Jodhpur buys umbrellas from Mahesh of Mumbai to be delivered to his Mithun living in Mumbai.

When Mahesh delivers the umbrellas to Mithun in Mumbai, it will be assumed that Jatin has received the goods at his principal place in Jodhpur. Place of supply will be Jodhpur in Rajasthan, Rajasthan and Maharashtra being different states, it will be inter-State sale chargeable to IGST.

2. Mayank of Mumbai places an order for two watches on Snapdeal (an e-commerce operator) manufactured by Foss Ltd., Bengaluru (registered with Snapdeal) to be delivered to his sister Hema in Hubli.

This is again a case of third party delivery. Delivery of watch to Hema in Hubli will be assumed to be delivery to Raju at his principal place in Mumbai by the Supplier Foss Ltd. (Bengaluru

Karnataka). Hence, Mumbai will be the place of supply and inter-State sales, IGST will be chargeable.

#### **4.2 When there is no movement of goods**

A. Where supply does not involve movement of goods, the place of delivery of goods will be the place of supply.

##### **Examples**

1. Alok of Ahmedabad has his goods lying in Punit's godown in Pune. Punit offers to buy those goods and Alok agrees to sell these goods to Punit.

In this case, there is no physical movement of goods. Delivery of goods is effected when Punit appropriates the goods. Place of service will be Pune. This being intra-state as the supplier and the place of supply both are in the same state CGST and SGST will be charged.

2. In the above example, If Alok sells goods to Ramesh in Pune, who takes the delivery from Punit, the place of supply will be Pune. Pune and Ahmedabad being in different states, IGST will be charged.

3. Johor, a Mumbai based film producer purchases a studio in Kolkata with pre-installed audio-visual equipments. The place of supply is Kolkata being the location of equipments at the time of delivery along with the studio building, which is same as the location of the supplier. Hence, CGST and SGST will be charged as intra-State sale. There will be no GST on sale of building being a capital asset.

##### **B. The goods assembled or installed at site**

Where, goods are assembled or installed at the site of the buyer, site will be the place of supply.

##### **Example**

Infosys Ltd., Bengaluru installs a sophisticated internet-server for MTNL in Mumbai.

This is a case of installation of server at the buyer's place in Mumbai. The place of supply is the site i.e. Mumbai. This being an inter-State sale from Bengaluru (Karnataka) to Mumbai (Maharashtra), IGST will be charged. However, Infosys may apply for registration as casual taxable person in Mumbai and pay CGST & SGST.

**C. Goods Supplied on a Vessel/Conveyance**

Where the goods are supplied on board a conveyance including any vessel, aircraft, train or a motor vehicle, place of supply is the location where such goods are taken (loaded) on board.

**Examples**

1. A buys food articles on board while travelling from Kolkata to Guwahati by air.

Kolkata being the place, where the food items are loaded into the plane, is place of supply. If the Airline is registered in Kolkata, CGST & SGST will be charged. But if the Airline is registered in other state e.g. Mumbai (Maharashtra), IGST will be charged. (In practice, most airlines being registered across the country, charge CGST/SGST.)

2. Kamal, a consultant for JW Ltd, Indore buys food articles on board, while flying from Patna to Lucknow. CGST & SGST will be charged as inter-State sales in Indore (M.P.) being the place of supply, where the food articles were loaded.

3. Kutty is travelling from Jaipur (Rajasthan) to Kochi (Kerala) Himgiri express starting from New Delhi (NCR). He buys lunch on board at Wadi in Andhra. The lunch was loaded by the IRCTC in Solapur (Maharashtra).

The food items were loaded in Solapur, hence place of supply is Solapur (Maharashtra). Since IRCTC is registered throughout India, CGST & SGST will be charged.

D. Where place of supply cannot be determined, the Parliament will make rule on the recommendation of GST Council.

E. Where, supply is by transfer of documents, place of supply will be the principal place of business of the person receiving the supply.

**Example**

Dilip of Dehradun (Uttarakhand) sells goods by endorsing airways bill for goods lying in Mumbai, from where the buyer takes the delivery of the goods. The place of supply is in Mumbai (Maharashtra) being the principal place of business of the person receiving the supply. It will be inter-state sales and IGST will be charged.

F. In case of import of goods into India, place of supply is location of the importer and IGST will be charged?

**Example**

A toy dealer having his principal office in Puri (Odisha) imports Chinese toys in Mumbai port.

Place of supply is Puri. IGST will be charged on the value of imports

G. In case of export of goods outside India, place of supply is outside India. Exports are exempt from GST.

**Example 2**

A of Patna exports garments to, San Francisco, U.S. from Kolkata airport. .

Place of supply will be in San Francisco. Exports are exempt from GST.

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## **8. PLACE OF SUPPLY IN RESPECT OF SERVICES WHEN LOCATION OF THE SUPPLIER AND RECIPIENT IS IN INDIA**

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Section 12 of the IGST Act lays down the principles for determination of place of supply in case of supply of services, when location of the supplier and recipient is in India, which are as under:

**1. General Rule**

Where the services are provided to a registered person, place of supply of services is place of location of the registered recipient of services.

**Example**

A computer mechanic provides services to a chartered accountant registered in Thane. Place of service will be in Thane.

2. Where, the recipient is not registered, place of supply is the address on record of the recipient.

**Example**

In the above illustration, the chartered accountant is not registered and his address on record is at Pune. Place of service will be at the address on record (i.e. Pune)

3. In other cases, it is location of supplier of services.

**4. Immovable Properties-Architects, surveyor etc.**

Place of supply of services in case of services related to immovable property like architects, interior decorator, property agents, surveyors, engineers, hotels, inns, guest houses, lodges,



club, banquet halls etc. shall be the location of the immovable property.

### **Example**

An U.S. Architect makes designs and plans for Trump Tower in Mumbai. Place of service shall be Mumbai as the service is related to immovable property located in Mumbai.

### **5. Performance based service**

In case of restaurant and catering, personal grooming services like beauty treatment, health, fitness etc. shall be the place of performance of these services.

### **Example**

A bridal makeup artist of Mumbai goes to provide service in wedding in Delhi. Place of service will be Delhi, where the grooming service was provided.

### **6. Transport & Insurance etc.**

Several services such as transportation of goods, transportation of passengers, Insurance etc, place of supply shall be the location of registered person.

### **7. Banking Services**

In case of banking, place of supply is location of the recipient on record.

### **8. Telecommunication services**

In case of telecommunication services involving fixed line, circuits, dish etc., place of supply is location of such fixed equipment.

### **Example**

In respect of set top box fixed at the homes of viewers, place of service will be at the place where such box is installed.

### **9. Mobile / Internet Services**

- a) In case location of billing address of the recipient post-paid services.
- b) Place of sale of prepaid voucher.
- c) In address of the recipient in records in other cases.

### **Examples**

- 1. Billing Address for mobile phone of Rajua resident of Thane is at his Chandigarh home address. Place of service shall be Chandigarh.
- 2. Yashvant, resident of Chandigarh purchases an JIO prepaid talk-time voucher in Raipur, place of service shall be Raipur.

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## **9. PLACE OF SUPPLY OF SERVICES WHEN LOCATION OF EITHER THE SUPPLIER OR THE RECIPIENT IS OUTSIDE INDIA – SECTION 13**

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International transactions where both the recipient and the provider of service are outside India are not covered under GST in India. International transactions, where either of the service recipient or the service provider is outside India, place of service will be determined as per the principles laid down in section 13 of IGST, Act, viz:

### **A. General Rule**

In international transactions, place of supply of services shall be the location of recipient of service.

#### **Example**

A CA provides service to his counterpart in London, U.K. U/s 13 of the IGST Act, place of supply shall be London, U.K. being the location of the recipient of service.

### **B. Non- availability of the location of service recipient**

Where the location of service recipient is not available, the place of supply shall be location of the supplier of services.

#### **Example**

A CA provides consultancy services to a person outside India, whose location is not known, the place of service shall be India being the location of the supplier of services.

### **C. Services involving actual performance**

Services involving actual performance, place of actual performance of services will be location of service.

#### **Example**

Sonu Nigam performs at IAFA awards ceremony in Macau, the place of service shall be Macau, China.

### **D. Processing of goods**

When supply of service involves doing some activity on some goods, place of supply is location of goods.

#### **Example**

If packing of goods imported is to be done in London, the place of service shall be London for providing packing service.

### **E. Services related to immovable property**

Services related to immovable property, place of supply of services is location of immovable property.

**Example**

An Engineer in India makes structural plans for a tower in Dubai. The place of service will be Dubai, not India.

**F. Event based Services**

Place of supply with respect to event based services like exhibition, conference, fair etc. shall be place where such events are held.

**Examples**

1. A decorator organises a business fair in Rome, the place of service will be Rome.
2. A Hollywood based American event manager organises Oscar award ceremony in Mumbai. The place of service shall be Mumbai. The event manager will have to take registration as a non-resident taxable person at least five days advance of the event.

**G. Services of Banking companies, transport hiring and intermediaries**

In case of banking company, or intermediary services or hiring of means of transport etc. shall be location of the supplier of services.

**Example**

1. A German company gives buses on rent to an Indian troupe visiting Berlin and charts a plane for returning to Mumbai. Place of service will be the location of supplier in Germany.
2. Bank charges payable to a Swiss bank in Geneva, the place of service will be Geneva, Switzerland.

**H. Transportation of goods**

Place of supply in case of transportation shall be place of destination of such goods.

**Example**

1. For a truck carrying goods to Nepal, the place of service shall be Nepal.
2. All ocean going ships or air crafts, place of service will be the destination port.

**I. Transportation of passengers**

In case of transportation of passengers, place where the passenger embarks on the conveyance.

**Example**

A travel agent carries passengers from Hardwar to Mansrovar in China, the place of service shall be Hardwar.

**J. Online data information**

Place of supply of services in case of online information and database access, place of recipient of services.

**Example**

Charges paid to google or Facebook for making available or data information in India, the place of service shall be India.

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**10. VALUE OF SUPPLY OF GOODS OR SERVICES-  
SECTION 15**


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Value of supply is the basis for computing tax liability by way of CGST / SGST / UTGST or IGST payable. The liability is calculated *ad valorem* with reference to the value of the supply of goods and/or services.

As per section 15 (1), “value of taxable supply” will be the transaction value and “transaction value” means the price paid or payable for supply of goods and/ or services if: -

- (i) The supplier and the recipient are not related; and
- (ii) Price is the sole consideration for the supply.

Transactional value is the value at which unrelated parties would transact in the normal course of business at normal price being the sole consideration. In cases where the parties are related (e.g., sister concerns) and a reasonable value may not be charged, or transaction may take place as a barter or exchange, the Act provides for determination of the transactional value’.

The phrase “price is the sole consideration for supply” implies that

- Value of any additional consideration received, whether monetary or non-monetary, and
- Payment made directly or indirectly by the recipient to the supplier will constitute the price actually paid or payable and shall be added to the consideration to arrive at the transaction value.

**Illustration**

Ashok sells a computer to Babu for Rs. 50,000 payable in cash and subject to the condition that Babu shall waive an old loan of Rs 50,000 due to him by Ashok. In this case the price of Rs.50,000 is not the sole consideration for sale. The loan of Rs. 50,000 written off will also be the part of the consideration for supply of goods. The value of the transaction will be Rs one lakh not, Rs. 50,000.

U/s 15(2) Transaction value will include:

- (a) Any taxes, duties, cesses, fees and charges levied under any statute, if charged separately by the supplier to the recipient. Municipal taxes, import duty are the examples of such taxes. However, taxes under this Act i.e. CGST/IGST/ SGST/ UTGST/ Cess etc will not be included in transaction value.
- (b) any amount that the supplier is liable to pay in relation to the supply, but which has been incurred by the recipient of the supply and not included in the price actually paid or payable for the goods and/ or services. In other words, where the supplier is under an obligation for which receiver has made the payment, such payment in connection with the supply i.e. Transportation will form part of transaction value.

### **Illustration**

A purchase a computer on onsite installation basis from B. A collects the computer from B and pays freight and installation charges. This expenses as per the original contract are to be incurred by B, will be included in the transaction value of the computer.

### **(c) Incidental expenses**

Any incidental expenses, such as commission *and* packing, charged *by* the supplier to the recipient of a supply, including any amount charged for *anything done* by the supplier in respect of the supply of goods and /or services at the time of, or before delivery of the goods or supply of the services;

### **Illustrations:**

(1) A buys ice cream from Naturals and pays Rs 50 for special dry-packing for home delivery. Cost of such packing will be included in the value of ice cream even if it is separately paid by the recipient.

(2) A suppliers supplies a diary of Rs. 500 and asks the recipient to pay Rs. 50 as the commission to the agent appointed by the supplier to procure the orders and remit the balance Rs. 450. Transaction value will be Rs. 500 inclusive of commission.

### **(d) Interest or Late Fees**

Interest or Late fee or penalty **for** delayed payment of any consideration will be part of transaction value

### **Illustration**

MTNL raises a telephone bill of Rs 500 payable within 15 days and Rs 600 if paid after 15 days. The interest or penalty of Rs100 will form part of the transaction value.

**(e) Subsidies**

Any subsidies directly linked to the price will form part of transaction value, unless such subsidies are provided by the Central or State Governments e.g. subsidy on gas cylinder, fertilisers or export subsidies.

**Illustration**

A Temple Trust grants subsidy linked to the price of household products like honey etc. produced by the members of its clan, the such subsidy will be included in the price.

**Exclusions from the Transaction Value- Section 15 (3)**

Discount will be excluded from the transactional value in the following cases

- (a) If discount is given before or at the time of the supply and such discount has been duly recorded in the invoice issued in respect of such supply;
- (b) If the discount is given after the supply has been affected, in terms of an agreement entered into at or before the time of such supply and
  - (i) such discount is specifically linked to relevant invoice;
  - (ii) Input credit attributable to the discount has been reversed by the recipient.

**Illustrations**

- (1) Under a sales promotion scheme, Maruti offer a 5% discount to the dealer who achieves a certain volume of turnover. Maruti Ltd. sells a car of Rs 10 lakh for Rs 9.50 lakh to the dealer indicating 5% discount in the invoice, the transaction value will be Rs. 9.50 lakh.
- (2) X purchases from Y goods for Rs 25,000 on 01/01/2018 on credit of one month., on 15/01/2018, Y gives a discount of Rs 3,000 and X pays Rs 22000 to settles his account. Transaction value will be Rs 25,000 as discount is not known before or at the time of supply.
- (3) In the above illustration if the invoice mentions that a discount of Rs 3,000 will be given if the payment is made before the due date, the transactional value will be Rs 22,000.

**Value of supply not determinable- Section 15(4) & 15(5)**

As per section 15(4), where the value of supply of goods or services cannot be determined under section 15(1), the same shall be determined in the prescribed *manner*. Further as per section 15(5), the value of supplies by the Central or a state Government, on the recommendation of the GST council shall be determined in prescribed. Manner in this regard following rules have been framed.

1. **Rule 1**—Where, the consideration is not wholly in money, the value will be the open market value of such supply, and if there is no open market, the sum total of consideration in money and any such further consideration not in money if such amount is known at the time of supply. If the value of supply is not determinable, value of like kind and quality of goods or services or as per rules 4 & 5.

### Illustrations

- (1) A washing machine under an exchange offer is available for Rs. 10,000 and Rs 12,000 without exchange. Open market value of the new machine will be Rs. 12000.
- (2) A desktop is exchanged for a laptop costing Rs. 25,000. Cost of the desktop is not known, then the value of desktop will be Rs 25,000.

2. **Rule 2.** Value of a supply between distinct or related person, will be the open market value of such supply, and if there is no open market, the sum total of consideration in money and any such further consideration not in money if such amount is known at the time of supply. If the value of supply is not determinable, value of like kind and quality of goods or services or as per rules 4 & 5 or where the recipient is eligible for full input tax credit, the value declared in the invoice shall be deemed to be the open market value of goods or services”

3. **Rule 3.** Value of supply of goods made or received through an agent will be the-

- open market value of goods supplied, or
- at the option of the supplier, 90% of the price charged for the supply of goods of like kind and quality by the recipient to his customer not being a related person, where the goods are intended for further supply by said recipient.

If the value of supply is not determinable, value of like kind and quality of goods or services or as per rules 4 & 5.

### Illustration

X supplies goods to his agent Y. Y sells like kind and quantity for Rs. 10,000. Z, another supplier gives like kind and quantity to Z for Rs. 8,000. Value of the supply goods will be Rs. 8,000 or at the option of X 90% of Rs 10,000 or Rs 9,000.

4. **Rule 4** - Where the value of a supply of goods/ services is not determinable by any of the preceding rules, *the value of supply shall be 110% of the following*

- (a) cost of production/ manufacture or
- (b) cost of acquisition of such *goods* or
- (c) cost of provision of such services.

5. **Rule 5-** Where the value of supply of goods or services or both cannot be determined under rules 1 to 4, *the same shall be determined using reasonable means consistent with the principles and general provisions of section 15 and these rules.* A supplier of services may opt for this rule, disregarding rule 4”

6. **Rule 6: Value of other supplies:**

(a) **Money changing**

Value of service for purchase or sale of foreign currency or money changing in Indian rupee (INR) will be the buying rate or selling rate less RBI reference rate and if there is no RBI reference rate, 1% of the gross amount of Indian Rupees received or given by changing of money. RBI reference rate is available for \$, USD, British pound, Euro and Yen only.

When neither of the currencies exchanged is Indian Rupee, the value of service will be equal to 1% of lesser of the two amounts, the person changing the money would have received by converting any of the two currencies at RBI reference rate.

**Illustration**

A changes US \$ 100 for Rs 69.72 against the RBI reference rate of Rs 69.45. Value of service-  $\text{Rs } 0.27 \times \$100 = \text{Rs. } 27$ . If RBI reference rate is not there, the value of service will be 1% of Rs 69.72 =  $\text{Rs } 69.72 \times 1\% = \text{Rs } 0.6972$ .

(b) **booking of air tickets**

Value of services on booking of air tickets will be 5% of basic fare for domestic bookings, and 10 % of basic fare for International booking. Basic Fare means the part of air fare on which commission is normally paid to the air travel agent by the airline

(c) **Life insurance agents**

Value of service will be the gross amount charged to the policyholder reduced by the amount allocated for investment on behalf of the policyholder, if such amount is intimated to the policy holder at the time of supply of service and 10% of the premium, in case of single premium annuity policies. For policies towards risk coverage only, the value will be tank at Nil.

(d) **Buying and selling of second hand goods**

Value of supply shall be the difference between the selling price and purchase price, and if the value of supply is negative it shall be ignored. However this subject to the condition that used goods are sold as such or after such minor processing which does not change the nature of the goods, and no input tax credit has been availed on purchase of such goods



**(e) Token/ Voucher/ Coupon/ Stamp**

Value of Token/ Voucher/ Coupon/ Stamp etc. will be equal to the money value of the goods or services or both redeemable against such token, voucher, coupon, or stamp.

7. **Rule 7** - The expenditure or costs incurred by the supplier as a pure agent of the recipient of supply of services shall be excluded from the value of supply on fulfilment of certain conditions. Example demurrage charges paid by customs house agent for their client's or property taxes paid by a housing society on behalf of the flat owners will be decocted if the same are paid as pure agent.

**Meaning of Certain terms :****(a) open market value**

A supply of goods or services or both means the full value in money, excluding the integrated tax, central tax, state tax, union territory tax and the cess payable by a person in a transaction, where the supplier and the recipient of the supply are not related and price is the sole consideration, to obtain such supply at the same time when the supply being valued is made.

**(b) Supply of goods or services or both of like kind & quality**

Any other supply of goods or services or both made under similar circumstances that, in respect of the characteristics, quality, quantity, functional components, materials, and reputation of the goods or services or both first mentioned, is the same as, or closely or substantially resembles, that supply of goods or services or both.

**(c) Related person**

- Officers or directors of one another's businesses
- legally recognised partners in business
- Employer and employee
- Any person who directly or indirectly owns, controls or holds 5% or more of the outstanding voting stock or shares of both of them
- One of them directly or indirectly controls the other
- Both of them are directly or indirectly controlled by a third person;
- Together they directly or indirectly control a third person
- Members of the same family

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**11. SELF- EXAMINATION QUESTIONS**

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1. What is the meaning of “location of the recipient of service?
2. Explain the term’ location of provider of service.
3. How the place of service is determined for supply of goods?
4. Explain the rules for determining place of supply of services.
5. What determination of place of service is important?
6. What are the types of taxes, How the will be affected by the place of service?
7. How the value of service will be determined?



## INPUT TAX CREDIT

### Synopsis :

1. Introduction and Objectives
2. Definition of Input Credit
3. Eligibility to claim input credit
4. Goods and Service not eligible for input credit
5. Document requirement
6. Reversal of Input credit
7. Utilisation of input credit
8. Matching of ITC
9. Conditions for availing ITC
10. Reversal of credit
11. Other provisions
12. Self-Examination Questions

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### 1. INTRODUCTION AND OBJECTIVES

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A seamless flow of input tax credit (ITC) across the chain from the manufacturer of the goods to till it reaches the end consumer across the country is the fundamentals feature of the GST tax regime. This lesson takes up for detailed discussion the provisions regarding the input credit and different aspect in relation to input credit as to who can or cannot claim the ITC, the supplies of goods and/or service in respect of which the ITC is allowable or not allowable, conditions and procedures for claiming ITC, cross utilization of credits of different taxes against one another and other relevant matters.

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### 2. DEFINITION OF INPUT TAX CREDIT

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#### **Input tax credit**

As per section 2 (63) of CGST Act, 2017, **input tax credit** (ITC) means 'the credit of input tax'

#### **Input tax**

As per section 2(62) **Input tax** in relation a registered person means

“the central tax, state tax, integrated tax or union territory tax charged on any supply of goods or services or both made to him and includes” —

- (a) the integrated goods and services tax charged on import of goods;
  - (b) the tax payable u/s 9 (3) and 9(4) of CGST Act.
  - (c) the tax payable u/s 5(3) and 5(4) of the IGST Act;
  - (d) the tax payable u/s 9 (3) and 9(4). SGST Acts
  - (e) the tax payable u/s 7(3) and 7(4) of UTGST Act,
- but does not include the tax paid under the composition levy.

On a collective reading of the two sections, ITC is available in respect of taxes paid by way of CGST/IGST/UGST and IGST including taxes paid under the reverse tax mechanism (RCM) by the recipient of goods and / or services.

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### 3. ELIGIBILITY TO CLAIM INPUT TAX CREDIT:

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As per section 16, **every registered person** shall be entitled take credit of input tax charged on any supply of goods or services or both, which are used or intended to be used in the course or furtherance of his business only if he satisfies all the conditions as prescribed.

#### **Basic conditions for claiming ITC:**

As per section 16(1) and section 16 (2), ITC will be admissible only to table person who fulfils all the prescribed conditions laid down for claiming ITC; namely: -

1. The ITC is credited to the electronic credit ledger of such person provided in Common portal.
2. The person should be in possession of a tax invoice or debit note or other prescribed document issued by a registered supplier.
3. The goods and /or services have been received by him or his agent; physically or by transfer of documents.
4. he has furnished the return under section 39:
5. The tax charged has been paid to the government by the supplier either in cash or through utilisation of ITC admissible in respect of the said supply;
6. When goods are received in instalments or lots, ITC can be claimed only when the last lot / instalment is received.
7. No ITC will be allowed if depreciation has been claimed on tax component of a capital goods

8. A person registered under composition scheme in GST cannot claim ITC although received goods or services are used by him in furtherance of his business.
9. A non-resident taxable person on receipt of goods and services also cannot claim ITC except on goods imported by him.
10. ITC can be claimed if goods and/or service are used in furtherance of business. Accordingly, ITC can be claimed only for business purposes.
11. ITC will not be available for goods and / or services
  - a. exclusively used for personal use
  - b. exempt supplies and
  - c. Supplies for which ITC is specifically not available.
12. ITC may be availed for making zero-rated supplies; notwithstanding that such supply may be an exempt supply.
13. Zero rated supplies mean (a) export of goods or services or both; or (b) supply of goods or services or both to a SEZ developer or a SEZ unit.

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#### **4. GOODS AND/ OR SERVICES NOT ADMISSIBLE FOR INPUT TAX CREDIT:**

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##### **A. Ineligible goods and services:**

ITC is not available in respect of the supply of following goods and / or services: -

- (1) Motor vehicles and other conveyances except when they are used for making taxable supplies, namely: -
  - a. further supply of such vehicles or conveyances; or
  - b. transportation of passengers; or
  - c. imparting training on driving; flying, navigating such vehicles or conveyance;
- (2) The following supplies except where same category of goods or services is used for making outward supply or an element of mixed or composite supply namely: -
  - (i) Food and beverages services.
  - (ii) Outdoor catering services.
  - (iii) Beauty treatment services.
  - (iv) Health services.
  - (v) Cosmetic and plastic surgery.
- (3) Membership of a club, health and fitness centre.
- (4) The following supplies except when notified by the Government as obligatory to provide such service by employer to employee or

where same category of goods or services is used for making outward supply or an element of mixed or composite supply namely: -

- (a) Rent-a-cab services,
  - (b) Life insurance services,
  - (c) Health insurance services.
- (5) Travel benefits extended to employees on vacation such as leave or home travel concession.
- (6) Works contract services when supplied for construction (including re-construction, renovation, additions or alterations or repairs) of an immovable property (other than plant and machinery) except where it is an input service for further supply of works contract service.
- (7) Goods or services or both received by a taxable person for construction (including, re-construction, renovation, additions or alterations or repairs) of an immovable property (other than plant or machinery) even if used for furtherance of business.
- (8) Goods or services or both on which tax has been paid under composition scheme- u/s 10.
- (9) Goods or services or both received by a non-resident taxable person except on goods imported by him.
- (10) Goods or services or both used for personal consumption.
- (11) Goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples.

“Plant and machinery “means apparatus, equipment, and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods or services or both and includes such foundation and structural supports but excludes:-

- (i) land, building or any other civil structure;
- (ii) Telecommunication towers; and
- (iii) Pipelines laid outside the factory premises.

#### **B. Apportionment of credit and blocked credits:**

ITC in following cases is subject to restrictions: -

- (1) No credit shall be availed in respect of any tax paid
  - u/s 74 of the CGST Act, in pursuance of any order where any demand on account of non-levy, short levy due to suppression of facts, any fraud, wilful misstatement recovered by the department., or

- u/s 130 of the CGST Act, in connection with any detention or seizure of goods, release of goods, confiscation of goods in transit.
- (2) Where the goods and/or services are used by the registered person partly for business and partly for other purposes, the amount of credit shall be restricted to so much of the input tax as is attributable to the purposes of his business.
- (3) Where the goods and/or services are used by the registered person partly for taxable supplies including zero-rated supplies and partly for exempt supplies under the CGST /IGST Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.

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## **5. DOCUMENTS REQUIRED FOR CLAIMING INPUT TAX CREDIT**

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Under Rule 36 of the CGST Rules, ITC shall be availed by a registered person, including the Input Service Distributor, on the basis of any of the following documents, namely: -

- (1) An invoice issued by the supplier of goods or services or both;
- (2) A debit note issued by a supplier;
- (3) A bill of entry under the Customs Act, 1962 or rules made there under for the assessment of integrated tax on imports.
- (4) An invoice issued under reverse charge payment of tax;
- (5) An Input Service Distributors invoice or Input Service Distributor credit note.

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## **6. REVERSAL OF INPUT TAX CREDIT: -**

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Under Rule 37 of the CGST Rules, provides for reversal of ITC availed by a registered person in the following cases:

- (1) Credit on stocks on the relevant date, when a registered person
  - opts to go out from normal scheme to composition scheme, credit on stocks; or
  - surrenders his registration due to closure of business,
- (2) When capital goods on which credit has been taken, have been removed by the registered person after they have been put in use, putting into use.
- (3) When consideration for supplies is not made within 180 days of issuance of invoice.
- (4) When there is a mismatch of returns of supplier and recipient.

- (5) When credit has been availed twice against single document.
- (6) When credit has been availed on common inputs, reversal of credit to the extent of credit relating to exempted supplies or supplies for non-business purpose.

## 7. UTILISATION OF INPUT TAX CREDIT

Input tax credit can be utilised in the following manner: -

1. The supplier will transfer funds to /CGST/UTGST/SGST or IGST account in the state of origin. The payment may be made by utilising the ITC
2. The buyer in the destination state can utilise IGST credit for payment of CGST and SGST by the transfer of funds from IGST account.
3. The amount of ITC on account of IGST is allowed to be utilised towards the payment (a) IGST, (b) CGST and (c) SGST, in that order
4. The amount of ITC on account of CGST is allowed to be utilised towards the payment of (a) CGST and (b) IGST in that order, :-
5. The amount of ITC on account of SGST is allowed to be utilised towards the payment a) SGST and (b) IGST in that order.
6. Input tax credit of CGST and SGST cannot be cross utilised.
7. Set off of ITC not available to a person under composition scheme.

The manner of availment and utilisation of Input Tax credit of CGST, SGST, IGST and UTGST is given in the following Table.

SET OFF OF INPUT CREDIT			
Input Credit	UTILISATION OF INPUT CREDIT		
	First utilisation	Second Utilisation	Balance
CGST	CGST	IGST	No
SGST/UTGST	SGST/UTGST	IGST	No
IGST	IGST	CGST,	SGST/UTGST
Input tax credit of CGST and SGST cannot be cross- utilised. Credit of CGST cannot be used for payment of SGST / UTGST and Credit of SGST / UTGST cannot be utilized for payment of CGST.			



**Illustration -1**

Ashok of Aundh sells goods of Rs 10,000 to Ganesh of Goa. The CGST /SGST rate is 6% each and IGST rate is 12%. Ganesh sells these goods in Goa for Rs 12,000.

(a) This is a case of interstate supply of goods involving movement of goods between two different states viz. Maharashtra and Goa liable to IGST. Ashok has to transfer Rs 1200 to IGST account by paying cash or by utilising any ITC due to him.

(b) (i) For Ganesh, this being an intra-state supply within the state of Goa, liability will be Rs 720 towards CGST and SGST each. (6% on Rs 12,000),

(ii) Ganesh can avail credit of ITC in respect of IGST of Rs 1200

- Firstly , Rs 720 towards the CGST and
- Then balance Rs 480 towards the SGST.

G will have to transfer the balance of Rs 240 towards the SGST.

**Illustration -2**

Following is the summary of GST payable and input credit available to Ashok :

Tax	Output tax Liability	Input Tax Credit ( ITC)
	Rupees	
IGST	40,000	20,000
CGST	12,000	15,000
SGST	12,000	15,000

The tax payable will be calculated as follows:

Tax	Output tax Liability	Input Tax Credit			Cash Payment Balance
		IGST	CGST	SGST	
	Rupees				
IGST	40,000	20,000	3,000	3,000	14,000
CGST	12,000	NA	12,000	NA	0
SGST	12,000	NA	NA	12,000	0
Total	64,000	20,000	15,000	15,000	14,000

**Illustration -3**

Following is the summary of GST payable and input credit available to Ashok :

Tax	Output tax Liability	Input Tax Credit ( ITC)
	Rupees	
IGST	25,000	50,000
CGST	30,000	10,000
SGST	30,000	10,000

The tax payable will be calculated as follows:

Tax	Output tax Liability	Input Tax Credit			Cash Payment Balance
		IGST	CGST	SGST	
	Rupees				
IGST	25,000	<b>25,000</b>	<b>NIL</b>	NIL	0
CGST	30,000	20,000	<b>10,000</b>	NA	0
SGST	30,000	5,000	NA	<b>10,000</b>	15,000
Total	85,000	50,000	10,000	10,000	

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## 8. MATCHING OF ITC

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The final credit would be allowed only when details of supplies made by supplier match with the recipient's return of availing credit. The matching has to be done in respect of GSTIN of Supplier and GSTIN of recipient in respect of each supply and recipient, Invoice number, Debit Note number, Credit Note number, Taxable Value and Tax amount involved.

In case the details match or the return filed by supplier is accepted by recipient, the matter ends there. In such case an intimation of acceptance of credit would be sent to recipient in FORM GST MIS-I.

In case of mismatch of details, the discrepancy would be communicated to both the supplier and recipient, if the fault is that of supplier or only to the recipient, if fault is that of recipient.

**Mismatch of ITC**

The discrepancies could be –

- availing credit in excess of the tax declared by the supplier, or
- the outward supply is not declared by the supplier, or
- there is a second time claim of ITC by the recipient.

Where the discrepancy is due to -

- differences of figures of amount of supplier and recipient, or
- non-declaration of outward supply by supplier, the supplier would be asked to rectify the discrepancy in the return of month in which discrepancy is informed to him.

If the supplier fails to rectify the discrepancy, excess credit will be added to the output tax liability of recipient next month and the recipient will be liable to pay an interest @18% on the amount added to the output tax liability from the date of availing the ITC till the discrepancy is reflected in returns.

### **Re-claim of ITC on subsequent matching**

The recipient may re-claim the credit, if after reversal of credit by recipient, the supplier rectifies the discrepancies. Interest paid, if any will also be refundable by crediting the amount to the recipient's Electronic Cash Ledger.

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## **9. CONDITIONS FOR AVAILING ITC**

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### **A. Transitional Provisions of Input Tax Credit**

The registrants under Central Excise, Service Tax and VAT, who have migrated to GST will be entitled to claim the credits available under the old law, if

- such credits are covered under the GST law.
- The amount of Cenvat credit on inputs, capital goods and input services were carried forward in the last return filed under the old laws.
- Such credit is unavailed credit in respect of capital goods, i.e. the balance amount of credit that remains after subtracting the credit already availed.
- The registered person has not opted to pay tax under composition scheme.
- A declaration in FORM GST TRAN -1 has been filed within 90 days from appointed date, specifying amount of credit claimed and admissible as per earlier credit Rules
- Then ITC can be availed in Electronic Credit Register.

### **B. Conditions for availing ITC by new registrant**

Input tax credit will be admissible to new registrants, who were not registered person prior to 01-07-2017, only, if:-

- (i) Goods on which input tax credit is claimed were not unconditionally exempt from the whole of the duty of excise or not nil rated.

(ii) the document for procurement of such goods is available with the registered person.

(iii) In case these documents are not available input tax credit shall be allowed after the GST has been paid on such supplies at the following rate:-

- 60% ( 30% in case of IGST) in case of goods with CGST rate of 9% and more , or
- 40% ( 20% in case IGST) for other goods.

(iv) The registered person availing of this scheme and having furnished the details of stock , submits a statement in FORM GST TRAN-2 at the end of each of the six tax periods during which the scheme is in operation indicating the details of supplies of such goods effected during the tax period.

(v) The amount of credit allowed shall be credited to the electronic credit ledger of the applicant maintained in FORM GST PMT-2 on the common portal.

(vi) The stock of goods on which the credit is availed should be identified by the registered person.

**C. Transfer of credit on sale / merger/ amalgamation/ lease/ transfer etc.**

A registered person may transfer his unavailed ( unutilised) credit in the event of sale, merger, de-merger, amalgamation, lease or transfer or change in the ownership of business for any reason subject to the following :-

(1) The registered person furnishes the details in FORM GST ITC-02, electronically on the common portal along with a request for transfer of unutilized input tax credit lying in his electronic credit ledger to the transferee.

(2) In case of demerger, the input tax credit shall be apportioned in the ratio of the value of assets of the new units as specified in the demerger scheme.

(3) The transferor shall also submit a copy of a certificate issued by a practicing chartered accountant or cost accountant certifying that the sale, merger, de-merger, amalgamation, lease or transfer of business has been done with a specific provision for the transfer of liabilities.

(4) The transferee shall, on the common portal, accept the details so furnished by the transferor and, upon such acceptance, the unutilised credit specified in FORM GST ITC-02 shall be credited to his electronic credit ledger.

(5) The inputs and capital goods so transferred shall be duly accounted for by the transferee in his books of account

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## **10. REVERSAL OF CREDIT UNDER SPECIAL CIRCUMSTANCES**

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Under Rule 44(1) of CGST Rules, credit may be reversed relating to inputs held in stock of raw material semi-finished and finished goods or capital goods and the same shall, be determined separately for CGST/ SGST/UGST and IGST as under: -

- (a) for inputs held in stocks the credit shall be calculated proportionately on the basis of the corresponding invoices on which credit had been availed by the registered taxable person on such inputs;
- (b) for capital goods held in stock, the credit involved in the remaining useful life in months shall be computed on pro-rata basis, taking the useful life as five years.
- (2) Where the tax invoices related to the inputs held in stock are not available, the registered person shall estimate the amount based on the prevailing market price of the goods on the effective date of the occurrence of any of the events.
- (4) The credit so determined shall form part of the output tax liability of the registered person and the details thereof shall be furnished in
  - FORM GST ITC-03, in case the credit relates to any event , and
  - FORM GSTR-10, where the credit relates to the cancellation of registration.
- (5) The details furnished shall be duly certified by a practicing chartered accountant or cost accountant.
- (6) The amount of credit for the purposes relating to capital goods shall be determined in the same manner as specified and the amount shall be determined separately for input tax credit of CGST/SGST/UTGST/IGST.

Where the amount so determined is more than the tax determined on the transaction value of the capital goods, the amount determined shall form part of the output tax liability and the same shall be furnished in FORM GSTR-1.

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## **11. ITC ON CAPITAL GOODS AND IMPORTS**

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### **ITC on Capital Goods in GST**

- (a) ITC would be available in full without restriction where capital goods have been used for effecting taxable supplies and business activity.

- (b) No credit will be admissible capital goods used exclusively for effecting exempt supplies or non-business or personal activity.
- (c) Credit to extent of depreciation under Income Tax Act is not admissible.
- (d) Capital goods after taking credit can be sent to job-worker without reversing credit. The capital goods so sent to job-worker are to be returned within three years and otherwise the principal shall be liable to pay the tax along with applicable interest.

### **Input Tax Credit for importers**

Integrated Tax is paid on imports is entitled for Input Tax credit in terms of the bill of entry or any similar document prescribed under the Customs Act. However, the credit of basic customs duty (BCD) would not be available.

In case of goods imported by a unit or a developer of SEZ, for authorised operations are exempted from the whole of the IGST.

On import, Export Oriented Units (EOU), Electronic Hardware Technology Park, (EHTP), Software Technology Parks (STP), who are be eligible for BCD exemption, will have to pay IGST paid, but the credit of the IGST so paid shall be eligible. This credit can be utilized towards payment of CGST on Domestic Tariff Unit (DTA) clearance or refund can be claimed on accumulation of the IGST.

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## **12. OTHER PROVISIONS**

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### **(1) Offences and penalty**

- a. Demand/ Penalty on registered person for violation of ITC provisions

In case of violation of the ITC provisions by a registered person, section 73/74 enables the proper officer to issue a demand notice to recover the credit wrongfully availed and also impose a penalty upto 100% of such credit.

- b. Issue of false invoice

A person issuing invoice without supplying goods, thus enabling recipient to take credit without possession of goods is liable to a penalty equal to amount of ITC involved or Rs.1000/- whichever is higher.

- c. Prosecution

Prosecution can be initiated for the default, which is punishable for fine and imprisonment of one year upto five years depending upon amount of ITC involved.

**(2) Miscellaneous Provisions**

- (1) The value of exempt supply shall be calculated in terms of formula prescribed in rules and shall include supplies on which the recipient is liable to pay tax on reverse charge basis, transactions in securities, sale of land and sale of building.
- (2) A banking company or a financial institution including a non-banking financial company, engaged in supplying services by way of accepting deposits, extending loans or advances shall have the option to either comply with the provisions of formula so prescribed or avail of, every month, an amount equal to 50% of the eligible input tax credit on inputs, capital goods and input services in that month and the rest shall lapse.
- (3) Payment for supplies received has to be made within a maximum period of 180 days; otherwise ITC already claimed will be added, with interest to output tax liability.
- (4) If depreciation on capital goods has been claimed, then ITC to that extent is not admissible.
- (5) Registered person shall not be allowed to take ITC, if the same has not been credited within 1 year from the date of issue of tax invoice relating to such supply of goods or services or both.
- (6) ITC would also not be permissible if invoice or debit note is received after due date of filing return for September of next financial year or filing annual return whichever is later.

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**SELF-EXAMINATION QUESTIONS**


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1. What is Input tax?
2. Explain the concept of Input credit
3. Who are eligible for claiming ITC :
4. Enumerate the supplies not eligible for ITC
5. When can the ITC be reversed?
6. Explain the utilisation of ITC
7. What are the conditions for claiming ITC?
8. Can a person claim ITC who has not filed returns?



## LEVY AND COLLECTION OF GST

### Synopsis :

1. Introduction and Objective
2. Scope of supply
3. Composite and mixed supplies
4. Import of supply
5. Supply without consideration – Schedule-I
6. Activities treated as supply of goods / services -Schedule – II
7. Activities neither supply of goods nor services- Schedule-III
8. Non- taxable & Non- GST Supplies
9. Composition levy
10. Levy and collection of tax
11. Exemption from tax
12. Self-examination- questions

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### 1. INTRODUCTION AND OBJECTIVE

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Levy and collection of GST, to a great extent depends upon the of supply of goods, services or both with their many faces such as exempt supply, nil-rated supply, zero-rated supply etc. The lesson seeks to explain all these concepts and further explains the concept of composition scheme for small taxable persons.

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### 2. SCOPE OF SUPPLY

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#### 2.1. Meaning and Scope of Supply

As per Article 366 (12A) of the Constitution of India “Goods and Services Tax” means “any tax on supply of goods or services or both except tax on supply of alcoholic liquor for human consumption”.

Supply of goods and/or services is the taxable event, occurrence of which gives rise to levy and collection of GST. The section uses “supply”, a term wider than “sale” and this has the effect of including stock transfer or branch transfer with in the ambit of GST.



As per Section 7 of CGST Act, the term 'Supply' includes:

- (a) all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal lease or disposal of goods or services or both
  - made or agreed to be made by a person
  - for a consideration
  - in the course or furtherance of business;
- (b) Import of services whether or not in the course or furtherance of business
- (c) the activities specified in Schedule I, made or agreed to be made without a consideration; and
- (d) the activities to be treated as supply of goods or supply of services as referred to in Schedule II.

#### **Exceptions:**

As per section 7(2), following shall be treated neither as a supply of goods nor a supply of services.

- (a) Activities or transactions specified in Schedule III;
- (b) Notified activities or transactions undertaken by the Central Government, a State Government or any local authority in which they are engaged as public authorities on the recommendations of the Council.

U/s 7(3), Subject to the above provisions, the Government may, on the recommendations of the GST Council, specify, by notification, the transactions that are to be treated as

- (a) a supply of goods and not as a supply of services; or
- (b) a supply of services and not as a supply of goods.

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### **3. COMPOSITE AND MIXED SUPPLY**

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#### **3.1. Composite Supply**

As per section 8(a) of CGST Act, composite supply comprising two or more supplies, one of which is a principal supply, shall be treated as a supply of such principal supply. The tax rate of principal supply will apply to other supplies also.

Defined in section 2(30), "composite supply" means a supply made by a taxable person to a recipient consisting of two or more taxable supplies of goods or services or both, or any combination thereof, which are **naturally bundled** and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply;

#### **Illustrations**

- (1) Where goods are packed and transported with insurance, the supply of goods, packing materials, transport and insurance is a composite supply and supply of goods is a principal supply;

(2) An air ticket includes cost of meals and free airport transfer. These services are bundled together. The principal supply will be transportation of passengers.

### **3.2. Mixed Supply**

As per section 8(a) of CGST Act, a mixed supply comprising two or more supplies shall be treated as a supply of that particular supply which attracts the highest rate of tax. E.g., Gift boxes containing different products having different rates, will be liable to highest rate of tax applicable to items contained therein. These are the supplies not naturally bundled.

As per section 2(74) “mixed supply” means two or more individual supplies of goods or services, or any combination thereof, made in conjunction with each other by a taxable person for a single price where such supply does not constitute a composite supply.

### **Illustrations**

1. A supply of a package consisting of canned foods sweets chocolates, cakes, dry fruits, aerated drinks and fruit juices when supplied for a single price is a mixed supply. Assuming the different product carry tax rate from zero to 28%, the package will be taxable at the highest rate 28%
2. Each of these items can be supplied separately and is not dependent on any other. It shall not be a mixed supply if these items are supplied separately.
3. A hotel provides a package inclusive of meals and sightseeing. Sightseeing is not natural bundling with accommodation hence, this does not amount to composite supply. This is a mixed supply hence; this will be a mixed supply not composite supply.
4. A combo- pack is available for Rs 1000 comprising of a key chain, wallet and a belt. This is a mixed supply as the articles are not naturally bundled

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## **4. IMPORT OF SUPPLY**

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Supply includes import of goods/ services irrespective of nature of use of these goods, whether for personal consumption or commercial use and will be liable to GST under Reverse Charge Mechanism (RCM). Conditions for Import of Service would be-

- a) Supplier of service is located outside India,
- b) Recipient of service is located in India and
- c) Place of supply of service is in India.

**Example**

Rahul pays fees for online coaching for CFA course from a coaching institution in New York. The fee will be liable to GST, although the coaching is personal, not for business or furtherance of business.

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**5. SUPPLY WITHOUT CONSIDERATION -SCHEDULE-I**


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Supply includes the activities specified in Schedule I, made or agreed to be made without a consideration. The schedule is as under: -

- (1) Permanent transfer or disposal of business assets where input tax credit has been availed on such assets.

**Examples:**

Disposal of old furniture by a company by giving away it in charities or transfer of plant to another unit located in another state.

- (2) Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business except gifts not exceeding fifty thousand rupees in value in a financial year by an employer to an employee

**Examples**

- 1) The transaction of providing corporate guarantee by a holding company to its subsidiary or *vice versa* in respect of loan raised from banks will be considered as supply although there may be no consideration for providing the guarantee.
- 2) Stock transfer made to a unit outside the state or to a different business vertical of the same assessee will be regarded supply.
- 3) Any supply of goods or services by employer to employee free of cost will be a supply. Subject to exemption of gift up Rs 50000 by the employer to employee in a financial year.
3. Supply of goods by: -
  - a principal to his agent where the agent undertakes to supply such goods on behalf of the principal; or
  - by an agent to his principal where the agent undertakes to receive such goods on behalf of the principal.
4. Import of services by a taxable person from a related person or from any of his other establishments outside India, in the course or furtherance of business.

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## 6. ACTIVITIES TREATED AS SUPPLY OF GOODS / SERVICES - SCHEDULE -II

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### Transfer of goods

- 1) Transfer of the title in goods;
- 2) Transfer of right in goods or of undivided share in goods without the transfer of title thereof, e.g. hiring out machinery, rent a cab etc.
- 3) Transfer of title in goods under an agreement, where by property in goods shall pass at a future date upon payment of full consideration as agreed, e.g. hire purchase agreement.

### Lease and tenancy

- 4) Lease, tenancy, easement, licence to occupy land;
- 5) Lease or letting out wholly or partly, of a building, a commercial, industrial or residential complex for business or commerce.

### Business assets

- 6) Treatment or process applied to another person's goods e.g. job work, processing charges, jewellery making dyeing of textile fabrics etc,
- 7) Transfer of business assets transferred or disposed of whether or not for a consideration, e.g. disposal of old furniture, office machines
- 8) Transfer of business assets to put to any private use or are used, or made available to any person for use, for any purpose other than a purpose of the business, whether or not for a consideration, e.g. using business vehicles for personal use by the proprietor / partners or employee, or giving company auditorium to employee for personal functions etc;
- 9) Any goods forming part of the assets of any business immediately before the taxable person ceases to be a taxable person, unless—
  - (i) the business is transferred as a going concern to another person; or
  - (ii) the business is carried on by a personal representative who is deemed to be a taxable person. e.g. – dissolution of firm.
- 10) Renting of immovable property e.g. renting an office or factory;
- 11) Construction (including additions, alterations, replacements or remodelling of any existing civil structure) of commercial or residential complex (including a complex or building intended for sale to a buyer) except where the entire *consideration has been received after issuance of completion certificate* by the competent authority (or an architect or chartered engineer; or

a licensed surveyor ; if there is no competent authority ) where required, or before its first occupation, whichever is earlier.

- 12) Temporary transfer or permitting the use or enjoyment of any intellectual property right; e. g franchise
- 13) Development, design, programming, customisation, adaptation, upgradation, enhancement, implementation of information technology software; e.g. Programming or development of IT software.
- 14) Agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act e.g. damages for inefficient services, penalty imposed for late completion of agreed contract, etc.
- 15) Transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration.
- 16) Composite supplies by way of or as part of (a) works contract or any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (other than alcoholic liquor for human consumption), where such supply or service is for cash, deferred payment or other valuable consideration (e.g. catering service Restaurant service).
- 17) Supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration. E.g. Supply of food, gaming tools, books etc. by any club to its members.

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## **7. ACTIVITIES NEITHER SUPPLY OF GOODS NOR SERVICES- SCHEDULE-III**

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1. Services by an *employee to the employer* in the course of or in relation to his employment.
2. Services by any *court or tribunal including a district court*, high court or Supreme Court established under any law for the time being in force.
3. The functions performed by the *Members of Parliament (MPs)*, Members of State Legislature (MLAs), Members of Panchayats, Municipalities and other local authorities;
- b. The duties performed by any person who *holds any post* in pursuance of the provisions of the *Constitution* in that capacity; or
- c. The duties performed by any person as a *Chairperson* or a *Member* or a *Director* in a body established by the Central

Government or a State Government or local authority and who is not deemed as an employee;

4. Sale of land /Building (subject to building under construction as per schedule II.
5. Actionable claims, other than lottery, betting and gambling.
6. Services of *funeral, burial, crematorium or mortuary* including transportation of the deceased.

These services were excluded from the definition of service or were in negative list under the Service Tax regime. This will mean these activities will be exempt from GST as well.

### **Other points**

1. Mutuality is not relevant to determine whether any activity is service.
2. Profit motive not relevant.

Clubs societies catering to their members on a no profit no loss basis will still be liable to GST subject to other exemptions available, if any.

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## **8. NON TAXABLE SUPPLY AND EXEMPT SUPPLY**

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### **8.1. Non-taxable supply**

As per section 2(78) of the Act “Non-taxable supply” means a supply of goods or services or both which is not leviable to tax under this Act or under the Integrated Goods and Services Tax Act.

### **8.2. Exempt supply**

As per section 2(47) of the Act “exempt supply” means a supply of goods or services or both which attracts nil rate of tax or which may be wholly exempt from tax under section 11, or under section 6 of the Integrated Goods and Services Tax Act and includes non-taxable supply.

### **8.3. Zero Rated Supply**

As per section 16 of IGST Act, zero rated supply means export of goods and/or services or supply to SEZ / SEZ Developer. Credit of Input Tax Credit (ITC) is available on zero rated supply. This means supply is taxable but rate of tax is zero hence ITC is available.

A person making zero rated supply will be eligible to claim refund of unutilised ITC or IGST (if not under LUT or Bond) paid on such exports.

### 8.3 Non-taxable, Exempt, Nil Rated Supply and Non- GST Supply

Section 7 defines what is supply, section 2(47) and 2(78), which define exempt supply and non-taxable supply begin with the opening words “supply. The cumulative result of the provisions is:

(a) There should be an activity, which is a supply.

(b) Schedule-III give a list of activities which are treated neither as supply of goods nor of services. Such activities are not “supply” and cannot be said to be either non -taxable supply or exempt supply.

All activities or transactions as per schedule -III or undertaken by Government and local authority as public authorities may be termed as non-GST supply, although no such term is defined in law.

(c) If no tax is be leviable on such supply either under CGST/ SGST or under IGST, it will be “non-taxable supply”.

(d) Supply of alcoholic liquor for human consumption, petroleum crude, high speed diesel, motor spirit, natural gases and aviation turbine fuel are “supply” on which not tax is levied, will be ‘non-taxable supply’.

(e) If the supply is wholly exempt or attracts nil rate of tax, it will be called nil-rated, zero rated or exempt supply. This term is again referred to in connection with refunds as “zero rated supplies made without payment of tax”.

The Central Government vide two notifications No. 02/2017 and 12/2017, have exempted a number of services u/s 11. The effect of such notifications is that the supply otherwise taxable will attract no tax or zero -tax rate because of these notifications. Some of the Services which are exempt from Tax are

- Services by a charitable trusts registered u/s 12AA of the Income Tax Act.
- Services by way of transfer of a going concern.
- Services provided to Government with certain conditions.
- Service by way of renting of residential dwelling for residential purposes.
- Intra- state supply of goods and/or services received by a registered person from an unregistered person where the value of such goods are not above Rs 7,500 per day) section 9(4)– (currently the provision kept in abeyance),
- Service imported by a SEZ Unit or SEZ developer.

Nil- Rated supply of goods has not been defined anywhere in CGST Act but support services to agriculture, forestry, fishing and animal husbandry, is the lone service notified as Nil rated supply of service.

(f) In case of NIL rated supply, the tariff is at NIL rate so there is no tax without the exemption notification but in case of exempt supply, the tariff is higher than 0% in case of exempt supply. But there is no tax payable due to exemption notification. Exports will be zero rated supply. As per IGST , service to SEZ developers/ esports are considered as zero-rated supplies

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## 9. EXEMPTION FROM TAX

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U/s 11(1), the Government has the power to grant general exemption :-

- to goods and/or services of any specified description
- either absolutely or subject to such conditions as may be specified,
- from the whole or any part of the tax leviable thereon
- from the date specified in the notification issued
  - in public interest;
  - on the recommendations of the Council

Such exemption can be granted to only class of goods not to specific persons.

U/s 11(2), such exemption from payment of tax to any goods or services or both on which tax is leviable. May be granted by special order in each case under circumstances of an exceptional nature to be stated in such order

U/s 11(3) empowers the Government the power to insert with in one year, an explanation to the notification.

Further, the registered person supplying such goods or services or both shall not collect the tax, in excess of the effective rate, on such supply of goods or services or both.

The Government has issued several notifications granting total or partial exemption in some cases as below:-

- A. Absolute exemption granted to following classes of supplies: -
- a. Transmission or distribution of electricity.
  - b. Renting of residential dwelling for use as residence.
  - c. Services by Reserve Bank of India.



- d. Services by a veterinary clinic in relation to health care of animals or birds
- e. Electricity, Salt, fresh fruits, potato, tomato, onion, plastic bangles, passenger baggage etc. (149 items of goods)
- B. Conditional exemption granted to following classes of supplies:-
  - a. Exemption from payment of tax under reverse charge basis granted to intra- state supply received by
    - a deductor u/s 51 from unregistered person, who is otherwise not required to registered under GST,
    - a registered person from unregistered person, dealing in buying and selling of second hand goods and who pays the central tax on the value of outward supply,
  - b. a registered person from unregistered person, the aggregate value of such supplies received by a registered person from all or any of the suppliers does not exceed Rs. 7500 in a day. (Currently the tax is kept in abeyance)
  - c. Services by a hotel, inn, guest house, club or campsite, by whatever name called, for residential or lodging purposes, having declared tariff of a unit of accommodation less than Rs. 1000/- per day
  - d. Concession rate of 2.5% to specified goods required in connection with various kinds of petroleum operations undertaken
  - e. Supplies by CSD to unit run canteens and supplies by CSD / unit run canteens to authorised customers
  - f. Supply of 81 services under CGST Act which were exempted under old service tax law.
  - g. Intra -state supply of heavy water and nuclear fuels by the Department of Atomic Energy to the Nuclear Power Corporation of India Ltd.
  - h. services provided by fair price shops to Government and those provided by and to FIFA for FIFA U-17
  - i. right to admission to the events at under FIFA U-17 World Cup 2017

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## 10. COMPOSITION LEVY

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### Meaning of Composition Scheme:

Section 10 of the CGST provides for an optional simplified composition scheme for the benefit of small dealers and small manufacturers and by reducing their burden of compliances. Such as reducing number returns to be filed, maintenance of books and records as compared to general dealer etc.

### Eligibility

The scheme is available only to taxable persons being

- manufacturers of goods,
- dealers, and
- restaurants (not serving alcohol)

having aggregate turnover of Rs 1 Crore during the preceding financial year.

Turnover Limit is Rs. 75 lakhs for Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Rs 1 crore for the rest of India including the states of Jammu & Kashmir and Uttarakhand.

### Ineligibility

Composition option cannot be exercised in the following specific cases:

1. Supply of services (including goods treated as *supply of services* by Schedule II) except the services covered under Schedule II, Paragraph 6(b) such as restaurants.
2. Supply of goods viz.
  - Non-taxable goods
  - Inter-State outward supplies
  - Through e-commerce operators required to collect tax at source/s 52.
  - Notified goods manufactured by the supplier
3. Manufacture of:
  - Ice cream and other edible ice, whether or not containing cocoa
  - Pan masala
  - All goods, i.e. Tobacco and manufactured tobacco substitutes

### Aggregate turnover

Aggregate Turnover means the aggregate value of

- All taxable supplies (excluding the value of inward supplies on which tax is payable by a person on reverse charge basis),
- Exempt supplies (including non-taxable supplies),
- Exports of goods or services or both and
- Inter-state supplies of persons having the same Permanent Account Number, to be computed on all India basis but excludes central tax, State tax, Union territory tax, integrated tax and cess. [Section 2 (6)]

The definition of aggregate turnover is very wide and includes every supply whether covered under GST or not, taxable supplies, exempt supplies, non-taxable supplies, export supplies

and inter-state supplies. Further, the aggregate turnover is for all business registered under single PAN across India.

### Rate of tax

Under the scheme, the registered person whose aggregate turnover in the preceding financial year does not exceed Rupees 75,00,000/ 1 Cr, as the case may be; may opt to pay, in lieu of the tax payable by him, an amount calculated at such rate prescribed in the Rules 7 of the GST Rules as mentioned below:

Type of Business	CGST	SGST/ UTGST	Total
Manufactures and traders of goods	0.5%	0.5%	1%
Restaurants (not serving alcohol)	2.5%	2.5%	5%
Other service providers	NA	NA	NA

### Notes 1.

- (a) Other service providers not allowed to opt for composition scheme.
- (b) Different rate may be for manufacturers of notified goods.
- (c) For restaurants, the composite supply shall be treated as supply of service where the supply, by way of or as a part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (other than alcoholic liquor for human consumption), where supply or service is for cash, deferred payment or other valuable consideration.
- (d) The composition rate cannot be applied in case of inter-state supplies as the composition scheme is not available when the inter-state supply is made by the supplier.
- (e) If aggregate turnover on all India basis of preceding financial year exceeds Rs 1 Crore/ 75 lakh during this financial year, the supplier is required to pay tax as normal dealer from the following day.

### Impact of becoming a normal dealer from composition dealer

If during the current year turnover exceeds Rs. 75 Lakh, then the composition supplier is required to file a FORM GST CMP-04 within 7 days.

Details of stock and capital goods, as on the day when composition dealer is becoming as normal dealer, are required to file in FORM GST ITC-01 within 30 days to take the credit of input on the same.

### Terms and Conditions to opt for composition

1. A supplier will have to opt composition scheme for all businesses registered under one PAN.

2. After, opting for composition is prohibited from -

- a) making interstate outward supply (sale of goods in other states).
- b) making supply of tax-free or exempted goods,
- c) making supply through e commerce operator.
- d) getting registration as Casual Taxable Person, or Non-resident Taxable Person for making supply in places where he is not registered.
- e) Manufacturing goods notified u/s 10(2)(e).

3. The supplier is required to:-

- a) mention "Composition Taxable person not eligible to collect tax on supplies" on the Invoice,
- b) mention "Composition Taxable Person" on every notice, signboard displayed at all place of business.
- c) pay tax on reverse charge basis as provided in Section 9(3) i.e. Inward Supplies from notified persons and Section 9 (4) i.e. Inward Supplies from unregistered person.
- d) show that stock as on appointed day have not been purchased in the course of
  - Inter State Trade or commerce
  - Imported from a place outside India
  - received from his branch situated outside the state
  - received from his agent or principal outside the state
- e) pay tax on stock on appointed day, under reverse charge u/s 9(3)/9(4) otherwise he will lose his right to opt composition scheme.

4. A composition supplier should file quarterly return in GSTR-4 before the 18th of the following month after end of the quarter and also annual return in GSTR -9A.

5. Transitory provisions for a dealer migrating to GST on the appointed day i.e 01/07/2017

- a) To file duly signed application for Composition Scheme in GST in FORM GST CMP-01 by 31 July 2017
- b) To furnish the details of stock, including the inward supply of goods received from unregistered persons, held by him on the day preceding the date from which he opts for composition, electronically in FORM GST CMP-03 within 60 days of the date from which composition scheme is opted.

Once option exercised u/s 10, it shall remain valid so long as the taxable person satisfies all the conditions mentioned in section 10 and Composition Rules.

6. If any registered person i.e. normal dealer wants to opt Composition Scheme shall electronically file intimation in FORM GST CMP-02 prior to the commencement of financial year and also submit FORM GST ITC-3 within 60 days from the commencement of the relevant financial year.
7. In addition to the above, he shall pay an amount, by way of debit in the electronic credit ledger or electronic cash ledger, equivalent to the credit of input tax in respect of inputs held in stock and inputs contained in semi-finished goods or finished goods held in stock and on capital goods, reduced by such percentage points as prescribed in ITC rules on the day immediately preceding the date of exercising such option.
8. Any intimation for opting composition scheme for any place of business shall be deemed for all other place of business.
9. After opting for composition scheme, the supplier cannot collect tax from the recipients of supply, but he shall issue bill of supply for supplies made thereafter.
10. No credit will be available to a registered taxable person on the invoice of a composition taxable person. Hence, composition scheme is not viable on B to B basis.
11. IGST dealer are not eligible to take the benefit of composition scheme.
12. In case of a normal dealer, who opts for composition, all credit in his ledger will lapse and included in the cost of goods u/s 18(4).
13. A composition taxable person will not be entitled to claim for Input Tax credit. Product. Such credit will become his cost of goods.
14. A taxable person may opt out from the composition scheme by filing an application in FORM GST CMP-04, electronically before the date of such withdrawal.

**Examples:**

1. Akash owns a restaurant and a grocery shop having turnover of Rs 15 lakh and Rs 90 lakh respectively.

Akash is eligible for composition restaurant services are eligible and the turnover does not exceed Rs 100 lakh during 2017-18.

2. Amit had during the F.Y. 2017-18 had the following turnover from one business:

Exempted goods	Rs 60 lakh
Non- taxable goods	Rs 25 lakh
Taxable goods	Rs 20 lakh

Aggregate Turnover includes all type of supplies registered under single PAN. A person supplying non-taxable goods is not eligible to opt for composition scheme. Moreover, the aggregate turnover exceeds Rs. 100 lakh. Hence, Amit is not eligible for composition Scheme.

3. Anuj is an architect running a consulting and a ceramics' shop having receipt of Rs 25 lakh and turnover of Rs 85 lakh respectively during the F.Y. 2017-18 and are registered in the same PAN.

In this case, consultancy services are not eligible for composition scheme. Hence Anuj is not eligible for composition scheme both in respect of his consultancy and his shop.

4. Anuj wants to opt for composition only in respect of his shop.

He cannot do so as all the business including the consultancy under one PAN have to be taken together.

5. Anuj, instead of consultancy owns a shop in building material having turnover of Rs 25 lakh during F.Y. 2017-18.

Although the businesses are eligible, turnover during the previous year exceeds Rs 100 lakh, hence not eligible for composition scheme.

6. Anuj has only one shop of Ceramics and no consultancy business.

Then, the turnover of Rs 60 lakh being below Rs 100 lakh, he will be eligible to opt for composition scheme.

7. M purchases goods in Mumbai (Maharashtra) sells in Panaji, Goa. His turnover during 2017-18 is Rs 69 lakh.

M is not eligible for composition to the turnover is of interstate outward supply.

8. Assuming, M purchases goods from Panaji and sells in Mumbai, he may go for composition as there is restriction on outward interstate supply not on inward interstate supply.

9. Sushil sells his goods through Amazon, an e commerce operator. Turnover of preceding financial year is Rs. 65 lakh.

Sushil is not eligible for composition scheme he sells goods through an e commerce operator.

10. Rogers of Imphal obtains registration as a casual taxable person in Kohima, Nagaland and records a turnover of Rs 42 lakh.

Roger being a casual taxable person has been specifically excluded from the composition scheme.

11. Turnover of Tony who has opted for composition, exceeds Rs 100 lakh on 15-04-2018. Tony will lose his option for composition from 16-04--2018. He will have file FORM GST CMP-04 within 7 days i.e. before 22-04- 2018, FORM GST ITC-01 within 30 days i.e. before 15 -05-2018 giving details of stock and capital goods, as on 22/04/2018 to claim ITC.

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## 11. LEVY AND COLLECTION OF TAX

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**11.1.** Section 9 of the CGST Act, 2017, which is the charging section, provides that for all intra state supplies of taxable goods or services or both, there shall be levied a tax called **central goods and services tax** (CGST) on the value as determined u/s Section **15** of the Act at such rates, not exceeding 20% (as may be notified by the Government on the recommendations of the Council). The section excludes from its ambit the supply of alcoholic liquor for human consumption.

### Example:

Jugal of Panaji in Goa supplies goods to D'sa in Vasco (Goa). The tax will be levied in Goa because goods will be consumed in Goa. Jugal will Charge CGST + SGST from D'sa

**11.2.** From the above it follows that for levy and collection of CGST following conditions must be satisfied: -

1. GST is levied on taxable intrastate supply of goods or services or both.

"Goods" means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply;

'Services' means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged;

2. The supply must be capable of being valued u/s 15.
3. The tax shall be levied /collected on the basis of the value so determined.
4. The rate of tax shall be at the prescribed rates not exceeding 20%.

GST rates has been announced on various goods/ services in 4 slabs at 5%, 12%, 18% and 28% apart from the nil rate and 0.25% on diamonds and 3% for bullion. The maximum rate of GST is 28% (i.e. 14% CGST+14% SGST). It can be increased maximum up to 40% (i.e. 20% CGST + 20% SGST) before cess on demerit items.

5. If the supply is not capable of being categorised under any of the prescribed rates category then tax cannot be levied on the same.
6. The CGST shall be levied and collected by the Central Government in the manner as prescribed GST - Payment of Taxes Rules, 2017.
7. The tax shall be payable by the taxable person. "Taxable person" means a person who is registered or liable to be registered under section 22 or section 24 of the Act".
8. Taxable person may not necessarily be the person who supplies the goods because the recipient of the service under the reverse tax mechanism(RCM), and e- commerce operator, and the registered taxable person in respect of supplies received from an unregistered person are liable to pay tax , not the supplier.
9. Tax cannot be collected from a person, who does not fall within the ambit of the definition of taxable person.
10. The section excludes from its ambit the supply of alcoholic liquor for human consumption.
11. CGST on crude oil, high speed diesel, aviation turbine, motor spirit (petrol), shall be levied with effect from the date to be notified by the Government on the recommendations of *Council*.  
- Section 9(2).

**Council:** means the Goods and Service Tax Council established under Article 279-A of the Constitution"- Section 2(36)

12. GST may be levied in three case under reverse tax mechanism (RCM), where the tax shall be paid on reverse charge basis by the recipient of such goods or services or both. All the provisions of this Act shall apply to the recipient as if he is the person liable for paying the tax. no reverse charge shall be applicable in case of exempt supply or non-taxable supply
  - a. The supply of notified goods or services or both, u/s 9(3). While as many as 12 services have been notified, good have not been notified under this section.
  - b. the supply of goods or services or both by unregistered person to a registered person u/s 9(4). Presently, the provision has been postponed.



- c. Intra-state supply of specific services supplied through the electronic commerce operator u/s 9(5)/ or its representative (to be mandatorily appointed) if such operator has no physical presence in the taxable territory.

**11.3.** In the following cases tax will be payable by the recipient of the goods and/or service or the electronic commerce operator.

1. Goods transport agency for service provided to casual taxable person, body corporate, partnership firm, any society, factory, any person registered under CGST, SGST, UTGST Act.
2. Recovery agent for a banking company, NBFC or any financial institution
3. A director of a company or a body corporate.
4. An individual advocate or firm of advocates, an arbitral tribunal providing representational services to any business entity.
5. Taxi driver or Rent a cab operator working through e-commerce operator ;
6. An insurance agent of an insurer.
7. Sponsorship received by a body corporate or partnership firm.
8. Importer receiving supply from non-taxable territory;
9. Copyright sold by an author or music composer, photographer, artist, to a publisher, music company, producer,
10. Any person who is located in a non-taxable territory to any person located in the taxable territory other than non-assessee online recipient (Business Recipient) Service recipient.

Value of taxable supply u/s 15, under the reverse Charge Mechanism (RCM) have been taken up separately in their appropriate place.

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## **12. SELF EXAMINATION QUESTIONS**

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1. What is meant by supply?
2. What is difference between naturally bundles and not so bundled supply and its impact on tax rate
3. Container sold with a vacuum flask is missed supply or composite supply, state with reason
4. What is composition scheme?

What are the advantages and disadvantages?

5. A German publisher takes Registration as a non-resident taxable person and he wants to opt for composition scheme. State with reason if he can do so?
6. What is exemption from tax?

