Centre for Distance & Online Education

UNIVERSITY OF JAMMU

JAMMU

SELF LEARNING MATERIAL

FOR

INCOME TAX

For the examination to be held in 2025 onwards

B.COM SEMESTER – IV **Unit I – IV**

COURSE NO. : BCG – 402 **LESSON NO. 1-20**

COURSE CO-ORDINATOR:

Prof.Sandeep Kour Tandon

TEACHER INCHARGE:

Dr. Sumeet Kour

http./www.distanceeducationju.in

Printed and Published on behalf of the Centre for Distance & Online Education

University of Jammu, Jammu

UNIVERSITY OF JAMMU

B.COM. FOURTH SEMESTER

INCOME TAX LAW AND PRACTICE -II

Course No.: BCG-402 — **Max Marks = 100**

Time : 3 Hrs. — **Internal Assessment = 20**

External Exam = 80

OBJECTIVES: To impart knowledge about basic concepts pertaining to theory and practice of income tax

UNIT I: CAPITAL GAINS

Meaning of capital assets; Short term and long term capital gain and loss, computation of capital gain, indexing of cost of acquisition and improvement.

Deductions u/s 54, 54B, 54D, 54EC, 54ED, 54F

Income from Other Sources: Computation of general income u/s 56(1) and specific income u/s 56(2), and grossing up of income falling under other sources, Interest on securities, types of securities.

UNIT II:

Set off and carry forward of losses, aggregation of income, deductions from gross total income for individuals, HUF's and Firms

UNITIII: Assessment of individuals and H.U.F including computation of tax liability.

UNIT IV: Assessment of firms and association of persons including computation of tax liability

SKILL DEVELOPMENT (GUIDELINES FOR CLASS ROOM TEACHING AND INTERNAL ASSESSMENT)

- Create deep understanding of all concepts specified in the syllabus.
- Enable the students in computing income and tax liability of various assesses as specified above.

BOOKS RECOMMENDED

1. Income Tax Law & Accounts by Dr. H C Meharotra and Dr S P Goyal: Sahitya Bhavan Publications.
2. Income tax Law and Practice by V.P.Gaur & D.B. Narang: Kalyani Publishers.
3. Direct taxes Law and Practices by V.K. Singhania & Kapil Singhania- Taxman publication.
4. Income tax Law and Practices by Mahesh Chandra, D.C. Shukla, K.A.Mahajan, M.A. Shah– Pragati Publication, New Delhi.
5. Conceptual clarity on Income Tax & Wealth Tax by Arvind Tuli &Dr. Neeru Chadda – Kalyani Publication, New Delhi

NOTE FOR PAPER SETTER

Equal weightage shall be given to all the units of the syllabus. The external paper shall be of the two sections viz, A& B of three hours duration.

Section-A: This section will contain four short answer questions selecting one from each unit. Each question carries 5 marks .A candidate is required to attempt all the four questions. Total weightage to this section shall be 20 marks.

Section-B: This section will contain eight long answer questions of 15 marks each. Two questions with internal choice will be set from each unit. A candidate has to attempt any four questions selecting one from each unit. Total weightage to this section shall be 60 marks.

MODEL QUESTION PAPER

INCOME TAX LAWAND PRACTICE – II

Max Marks: - 80 **Time allowed: 3hrs**

Section- A (Marks 20) **(5 Marks x 4)**

Attempt all questions. Each question carries five marks.

1. Discuss the concept of book profit with suitable example.
2. Write a short note on set off and carry forward of losses.
3. Calculate tax payable in case of individual for the assessment year 2025 - 26 with suitable example.
4. Discuss long term capital gain & short term capital gain.

Section- B (Marks 60) **(15 Marks x 4)**

Attempt any four questions selecting one from each unit. Each question carries 15 marks.

UNIT-I

1. Mr. X purchased a house in 1976 for Rs. 1, 00,000. He incurred the following expenses for the improvement of the house.

Renovation of the house for Rs. 25,000 and addition of 2 rooms after one year for Rs. 50,000. The F.M.V. of the house on 1-4-81 was Rs. 110,000. He sold the house in May 2012 for Rs. 14, 00,000.

He purchased another house property within 2 months for Rs. 3, 00,000 and invested in capital gains account scheme Rs. 50,000. Calculate taxable capital gain for the previous year 2024 - 2025. Cost inflation index for 1981-82 was 100 and for 1912-13 is 852.

OR

Following are the particulars for the year 2025. Compute income under the head income from other sources.

			Rs.
(i)	Card games loss		12,000
(ii)	From the activity of owning and Maintaining horses for race purpose		
	(a)	Loss at Bombay	40,000
	(b)	Profit at Bangalore	20,000
	(iii)	Dividend (gross)	6,000
	(iv)	Betting in horse races	400

UNIT-II

2. Mr. X earned gross total income of Rs. 5, 00,000. In the previous year 2024 -2025 and made the following donation during the year.

(i) Rs. 10,000 to chief Minister's earthquake relief fund.

(ii) Rs. 15,000 to National foundation for communal harmony.

(iii) Rs. 20,000 for Municipal Corporation approved for promotion of family planning.

(iv) Rs. 45,000 to approved institutions.

Calculate the amount of deduction admissible to him u/s 80G.

OR

Discuss with suitable example rules regarding set off and carry forward of losses.

UNIT-III

3. Mr. K.L Setha resident of Delhi [population above 25 lakhs] submits the following details of his income for the financial year……

Salary	7000 p.m
DA	6000 p.m
Entertainment Allowance	350 p.m
City compensatory allowance	250 p.m
Bonus	7000
Employer's contribution to RPF	12000
His own contribution to RPF	12000
Interest on RPF balance @ 13%	7800

He is provided with an unfurnished accommodation for which employer charges Rs. 200 p.m. The municipal value of the house owned by employer is Rs. 22050 p.a. He is also provided by employer with chauffeur driven car of 1.8 lt. capacity. The car is used for official purposes only and the entire expenses of its running and maintenance are met by the employer.

During the year Mr. K.L Seth has received dividends from co-op, society amounting to Rs. 14000. He paid insurance premium of Rs. 3000 on a policy taken on his the life of his father who is not dependent on him. During the year he had following income also.

(a) Winnings from lottery Rs. 50000 out of which tax @30% has been deducted at source.

(b) He went to Nepal and won Rs. 35000 from gambling in a casino.

(c) He lost Rs. 20000 in card games during Diwali season.

(d) He earned Rs. 14910 from his term deposits with a bank.

Computes his total income and tax liability for the assessment year 2025 - 2026

OR

HUF with more than one co-parcener entitled to claim partition, owns a property which is let out at Rs. 600 p.m per unit. The property consists of 10 identical residential units. The municipal rental value of the property is Rs. 60,000 p.a.

Following deductions are claimed as expenses:

	Rs.
Municipal taxes	4200
Lift maintenance	2000
Water pump expenses	800
Actual expenses on repairs	8000
Cost of renovation of the property	50000
Education cess levied by the state govt.	2000
Rent collector monthly salary	200
Interest on loan taken by mortgaging the property and loan was used for the family business	5000

Income from the family business for the assessment year 2025 – 2026 was Rs. 160000

after charging interest on loan. A lottery ticket worth Rs. 100 was purchased out of family funds on the name HUF. It won a prize of Rs. 100000. The Karta had acquired a shop out of his own savings which he wife. Shop has an annual income (computed under the head house property) of Rs. 24000.

Compute total income of HUF and tax payable for the assessment year 2025 -2026.

UNIT-IV

4. From the information given below find out the amount of remuneration which can be debited to P & LA/c of the firm and how much income of partners shall be chargeable to tax under the head profits and gains. Salary and interest to partners has been paid as per deed.

	Rs.
Books profit (after debiting the following)	40000
Following payments have been made as per partnership deed, which had been submitted along with return for the assessment year 2025 -2026	
Salary to X (working partner)	84000
Salary to Y (non working partner)	20000
Commission to Z (working partner)	60000
Interest on capital to partners @ 16%	
To X	12000
To Y	9000
To Z	6000

OR

Mr. K, Mrs. L and Mr. M are members of an AOP sharing profits and losses equally. During the year ending 2025 total income of AOP was Rs. 237000. The details of individual Incomes of its members are given below:

Mrs. K	**Rs.**
Rent from house property	60000
Interest on deposits with HUDCO	36000
Bank interest	50000
Mrs. L	
House property income (computed)	20000
Bank interest on fixed deposits	96000
Interest on debentures (gross)	30000
Mr. M	
Pension from government	136000
Interest accrued on NSC VIII issue	12600
Interest on Govt. securities	15000

Compute tax liability of AOP and its members.

UNIT – I **B.COM 4th SEMESTER**

COURSE No. BCG-402 **LESSON No. 1**

CAPITAL GAIN

STRUCTURE

1.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand the meaning of capital gains and why they are taxed under the Income-tax Act.
- Learn what is considered a capital asset and what is not.
- Know the difference between short-term and long-term capital assets based on holding period.
- Understand what is meant by transfer of a capital asset and when it is taxable or not taxable.

Learning outcomes

- Identify whether an item is a capital asset and check if capital gains apply.
- Classify capital gains as short-term or long-term based on how long the asset was held.
- Recognize different types of transfers and know which are taxable or exempt.
- Apply your knowledge to basic problems and examples involving capital gains.

1.1 INTRODUCTION

When a person sells something valuable like land, a house, shares, or jewelry, and makes a profit, that profit is called capital gain. This gain is considered income under the Income-tax Act, and tax has to be paid on it. The rules about how capital gains are calculated and taxed are explained in Sections 45 to 55A of the Act. The provisions for computation of Income from capital gains are covered under sections 45 to 55. Section 2(14) defines the term capital gain and section 45, the charging section lays down basis of change for taxability of capital gain/loss arises on transfer of capital asset. Taxability of capital gain depends upon the nature of capital gain arises, i.e., short term capital gain or long term capital gain. The type of capital gain depends upon the period for which the capital asset is held. The taxability of capital gain shall satisfy the conditions like there should be capital asset, the asset is transferred by the assessee, such transfer takes place during the previous year, etc Not every profit from selling an asset is taxable, and not every item is considered a capital asset. This chapter will help you understand what capital gain is, what a capital asset is, and how the income from selling such assets is taxed.

1.2 CONCEPT OF CAPITAL GAIN

Profits or gains arising from the transfer of a capital asset made in a previous year are taxable as capital gains under the head “Capital Gains”. Sections 45 to 55A of the Income-tax Act, 1961 deal with capital gains. Section 45 of the Act, provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, 54GA and 54H be chargeable to income-tax under the head “Capital Gains” and shall be deemed to be the income of the previous year in which the transfer took place. Doubts may arise as to whether ‘Capital Gains’ being a capital receipt can be brought to tax as income. It may be noted that the ordinary accounting canons of distinctions between a capital receipt and a revenue receipt are not always followed under the Income-tax Act. Section 2(24)(vi) of the Income-tax Act specifically provides that “Income” includes “any capital gains chargeable under Section 45(1)”. It may not be out of place to mention here that in the absence of a specific provision in Section 2(24) capital gains have no logic to be taxed as income. The constitutional validity of the provisions of the Act relating to capital gains was challenged in *Navin Chandra Mafatlal* v. C.I.T. (1955) 27 ITR 245. The Supreme Court while upholding the competence of parliament in legislating with regard to capital gains as part of income, observed that the term income should be given the widest connotation so as to include capital gain within its scope. However, all capital profits do not necessarily constitute capital gains. For instance, profits on re-issue of forfeited shares, profits on redemption of debentures, premium on issue of shares, 'pagri' from tenants etc. are capital profits and not capital gains, hence, not liable to tax. The capital gain is chargeable to income tax if the following conditions are satisfied:

1. There is a capital asset.

2. Assessee should transfer the capital asset.

3. Transfer of capital assets should take place during the previous year.

4. There should be gain or loss on account of such transfer of capital asset.

1.3 MEANING OF CAPITAL ASSEST

Capital Asset: Sec. 2(14): Capital Asset means property of any kind (Fixed, Circulating, movable, immovable, tangible or intangible) whether or not connected with business or profession. In other words property of any kind held by an assessee whether or not connected with his business or profession but does not include:

(i) Any stock-in-trade, consumable stores or raw-materials held for the purposes of his business or profession;

(ii) Personal effects that is to say, movable property (including wearing apparel and furniture but excluding jewellery) held for personal use by the assessee or any member of his family dependent on him. Jewellery includes 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 and precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;

(iii) Agricultural land in India, not being land situate (a) within the jurisdiction of a municipality or a cantonment board and which has a population of not less than 10,000, or (b) in any area within the distance, measured aerially, –

(I) not being more than two kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten thousand but not exceeding one lakh; or

(II) not being more than six kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than one lakh but not exceeding ten lakh; or

(III) not being more than eight kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten lakh.

Explanation: – For the purposes of this sub-clause, "population" means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year;

(iv) 6½ per cent Gold Bonds, 1977 or 7 per cent Gold Bonds, 1980 or National Defence Gold Bonds, 1980 issued by the Central Government;

(v) Special Bearer Bonds 1991 issued by the Central Government.

(vi) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

1.4 KINDS OF CAPITAL ASSESTS

There are two kinds of capital assets

1.4.1 Short-term capital asset: Sec. 2(42A): means a capital asset held by an assessee for not more than thirty six months immediately preceding the date of its transfer. However, in the following cases, an asset, held for not more than twelve months, is treated as short-term capital asset—

a. Quoted or unquoted equity or preference shares in a company

b. Quoted Securities

c. Quoted or unquoted Units of UTI

d. Quoted or unquoted Units of Mutual Funds specified u/s. 10(23D)

e. Quoted or unquoted zero coupon bonds

1.4.2 Long-term capital asset: Sec. 2(29A): means a capital asset which is not a short-term capital asset. Under the existing law, profits and gains arising from the transfer of capital asset made in a previous year is taxable as capital gains. A capital asset is distinguished on the basis of the period of holding. A capital asset, which is held for more than three years, is categorized as a long-term capital asset. However, if the capital asset is in the nature of equity, it is categorized as a long-term capital asset if it is held for more than one year. All capital assets other than long-term capital asset are termed as a short- term capital asset.

CHECK YOUR PROGRESS

Multiple Choice Questions (MCQs)

What is the term used for profit arising from the transfer of a capital asset?

- A) Capital Loss
- B) Capital Gain
- C) Revenue Income
- D) Business Profit
- **Answer:** B) Capital Gain

2. **Which of the following is NOT a capital asset as per the Income-tax Act, 1961?**
   - A) Agricultural land outside municipality limits
   - B) Gold Bonds issued by the Central Government
   - C) Stock-in-trade
   - D) Shares in an Indian company
   - **Answer:** C) Stock-in-trade
3. **What is the maximum holding period for an asset to be considered a short-term capital asset for quoted shares?**
   - A) 36 months
   - B) 12 months
   - C) 5 years
   - D) 24 months
   - **Answer:** B) 12 months
4. **Capital gains from the sale of which type of asset are generally considered long-term, if held for more than 3 years?**
   - A) Stock-in-trade
   - B) Jewelry
   - C) Real estate
   - D) Mutual Funds
   - **Answer:** C) Real estate
5. **Which section of the Income-tax Act defines "capital asset"?**
   - A) Section 45
   - B) Section 2(14)
   - C) Section 54
   - D) Section 49
   - **Answer:** B) Section 2(14)
6. **Which of the following capital assets does NOT qualify for long-term capital gain treatment?**
   - A) Agricultural land in rural areas
   - B) Shares of listed companies
   - C) Gold Bonds
   - D) Residential property
   - **Answer:** C) Gold Bonds

1.5 TRANSFER OF CAPITAL ASSESTS

Transfer includes:

• Sale of asset

• Exchange of asset

• Relinquishment of asset (means surrender of asset)

• Extinguishments of any right on asset (means reducing any right on asset)

• Compulsory acquisition of asset.

The definition of transfer is inclusive, thus transfer includes only above said five ways. In other words, transfer can take place only on these five ways. If there is any other way where an asset is given to other such as by way of gift, inheritance etc. it will not be termed as transfer.

1.5.1 Transactions which do not constitute transfer [Sections 46 and 47]

(i) Any distribution of capital assets on the total or partial partition of a Hindu Undivided Family;

(ii) any transfer of a capital asset under a gift or will or an irrevocable trust; Provided that this clause shall not apply to transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees' Stock Option Plan or Scheme of the company offered to such employees in accordance with the guidelines issued by the Central Government in this behalf;

(iii) Any transfer of a capital asset by a company to its subsidiary company, if– (a) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and (b) the subsidiary company is an Indian company;

(iv) Any transfer of a capital asset by a subsidiary company to the holding company, if – (a) the whole of the share capital of the subsidiary company is held by the holding company, and (b) the holding company is an Indian company;

(v) Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company;

(vi) any transfer in a scheme of amalgamation of a capital asset being share or shares held in an Indian Company, by the amalgamating foreign company to the amalgamated foreign company, if –

(a) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and

(b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated (applicable from the assessment year 1993-94);

(viaa) any transfer in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government under Sub-section (7) of Section 45 of the Banking Regulation Act, 1949, of a capital asset by the banking company to the banking institution. (vib) any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.

(vic) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if –

(a) the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated provided that the provisions of Sections 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demerger referred to in this clause.

(vid) any transfer or issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.

(vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if –

(a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholders itself is the amalgamated company, and

(b) the amalgamated company is an Indian company;

(viia) any transfer of a capital asset of such foreign currency convertible bonds or Global Depository Receipts as are referred to in Section 115AC(1) held by a non-resident to another non-resident where the transfer is made outside India (applicable from 1.6.1992);

(viii) any transfer of agricultural land in India effected before the first day of March, 1970;

(ix) any transfer of a capital asset being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States;

(x) any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company, into shares or debentures of that company.

(xi) any transfer made on or before 31.12.1998 by a person not being a company of a capital asset being membership of a recognised stock exchange to a company in exchange for shares allotted by that company to him (transferor).

(xii) any transfer of land by a sick industrial company made at any time beginning with declaration of it being sick by the BIFR and ending with the previous year in which its net worth wipes out the accumulated losses.

(xiii) where a firm is succeeded by a company in the business carried on by it as a result of which the firm sells or otherwise transfers any capital asset or intangible asset to the company: Any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of the demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company.

Provided that —

(a) all the assets and liabilities of the firm or of the association of persons or body of individuals relating to the business immediately before the succession become the assets and liabilities of the company,

(b) all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital account stood in the books of the firm on the date of succession.

(c) the partners of the firm do not receive any consideration or benefit, directly or indirectly in any form or manner, other than by way of allotment of shares in the company, and

(d) the aggregate of the share holding in the company of the partners of the firm is not less than fifty per cent of the total voting power in the company and their shareholding continue to be as such for a period of five years from the date of succession.

(e) the demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for corporatisation which is approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India Act, 1992.

(xiiia) any transfer of a capital asset being a membership right held by a member of a recognised stock exchange in India for acquisition of shares and trading or clearing rights acquired by such member in that recognised stock exchange in accordance with a scheme for demutualisation or corporatisation which is approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992).

(xiiib) any transfer of a capital asset or intangible asset by a private company or unlisted public company (hereafter in this clause referred to as the company) to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership

1.5.2 Year of chargeability to tax

Capital gains are generally charged to tax in the year in which 'transfer' takes place

1.6 MEANING OF CAPITAL GAIN

Any profits or gains arising from the transfer of a capital asset is called capital gain. Capital gain is an increase in the value of a capital asset (investment or real estate) that gives it a higher worth than the purchase price. The gain is not realized until the asset is sold. A capital gain may be short-term (one year or less) or long-term (more than one year) and must be claimed on incometaxes.

In other words, A capital gain refers to profit that results from a sale of a capital asset, such as stock, bond or real estate, where the sale price exceeds the purchase price. The gain is the difference between a higher selling price and a lower purchase price. Conversely, a capitalloss arises if the proceeds from the sale of a capital asset are less than the purchase price.

Capital gains may also refer to a different form of profit received from an asset which refers to "investment income" in the form of cash flow or passive income that arises in relation to real assets, such as property; financial assets, such as shares/stocks or bonds; and intangible assets.

CHECK YOUR PROGRESS

One-Word Questions

1. What is the term used for the profit made from selling a capital asset?
   - Answer: **Capital Gain**
2. What is the holding period for long-term capital assets for listed shares?
   - Answer: **12 months**
3. Which tax rate generally applies to long-term capital gains?
   - Answer: **20%**
4. Which of the following is considered a capital asset under Section 2(14)?
   - Answer: **Property**
5. What section deals with the taxability of capital gains?
   - Answer: **Section 45**
6. What is excluded from the definition of capital asset under Section 2(14)?
   - Answer: **Stock-in-trade**

1.7 SHORT TERM CAPITAL GAIN

Any capital gain arising as a result of transfer of a short-term capital asset is known as short-term capital gain. According to Section 2(42A) of the Income-tax Act: “Short term” capital asset means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. In the case of capital assets (being equity or preference share in a company) held by an assessee for not more than 12 months immediately prior to its transfer. In determining the period for which a capital asset is held by an assessee, the following must be noted:

(i) In the case of shares held in a company in liquidation, the period subsequent to the date on which the company goes into liquidation shall be excluded.

(ii) In case the asset becomes the property of the assessee under the circumstances mentioned in Section 49(1) – discussed later in this lesson - the period for which the asset was held by the previous owner shall be included.

(iii) In the case of the shares in an Indian Company which become the property of the assessee in a scheme of amalgamation, the period for which the shares in the amalgamating company were held by the assessee shall be included.

(iv) In the case of a capital asset, being a share or any other security subscribed to by the assessee on the basis of his right to subscribe to such financial asset or subscribed to by the person in whose favour the assessee has renounced his right to subscribe to such financial asset, the period shall be reckoned from the date of allotment of such financial asset;

(v) In the case of a capital assets, being the right to subscribe to any financial asset, which is renounced in favour of any other person, the period shall be reckoned from the date of the offer of such right by the company or institution, as the case may be, making such offer.

(vi) In the case of a capital asset, being a financial asset, allotted without any payment and on the basis of holding of any other financial asset, the period shall be reckoned from the date of the allotment of such financial asset.

(vii) In the case of a capital asset, being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, there shall be included the period for which the share or shares held in the demerged company were held by the assessee.

(viii) In the case of a capital asset, being trading or clearing rights of a recognized stock exchange in India acquired by a person pursuant to demutualisation or corporatisation of the recognized stock exchange in India as referred to in Clause (xiii) of Section 47, there shall be included the period for which the person was a member of the recognized stock exchange in India immediately prior to such demutualisation or corporatisation;

(viiia) In the case of a capital asset, being equity share or shares in a company allotted pursuant to demutualisation or corporatisation of a recognised stock exchange in India as referred to in Clause (xiii) of Section 47, there shall be included the period for which the person was a member of the recognized stock exchange in India immediately prior to such demutualisation or corporatization.

1.8 LONG TERM CAPITAL GAIN

Any capital gain arising as a result of transfer of a long-term capital asset is known as long-term capital gain. Long term Capital gains are computed by deducting from the full value of consideration for the transfer of a capital asset the following:

- Expenditure connected exclusively with the transfer;
- The indexed cost of acquisition of the asset, and
- The indexed cost of improvement, if any, of that asset.

1.9 DIFFERENCE BETWEEN SHORT TERM AND LONG TERM CAPITAL GAIN

Long Term Capital Gain	Short Term Capital Gain
It arises out of transfer of long term capital assets	It arises out of transfer of short term capital assets
Tax rate is 20%	Rates applicable to all other incomes
Cost of acquisition and cost of improvement are indexed on the basis of CII.	No indexing is done.
If LTCA is acquired before 1-4-1981, then the fair market value of the asset as on 1-41981 is taken as the value of acquisition.	No such option is available to STCA
Long term capital loss can be set off only against long term capital gain.	Short term capital loss can be set off against short term capital gain or long term capital gain.

CHECK YOUR PROGRESS

True/False Statements

1. Capital gains are only taxable if the transfer involves a profit.
   - Answer: **True**
2. Shares held for more than 36 months are considered short-term capital assets.
   - Answer: **False (They are considered long-term capital assets for most assets except listed shares.)**
3. Personal effects such as furniture are considered capital assets under the Income-tax Act.
   - Answer: **False (Personal effects like furniture and clothing are not considered capital assets.)**
4. Agricultural land in rural areas is a capital asset.
   - Answer: **False (Agricultural land in rural areas is not considered a capital asset under certain conditions.)**
5. The gain from the sale of a capital asset is not considered income and is exempt from tax.
   - Answer: **False (Capital gain is considered income and is subject to tax.)**
6. Long-term capital gains are taxed at a lower rate compared to short-term capital gains.
   - Answer: **True**
7. Any transfer of a capital asset through inheritance is considered a transfer for tax purposes.
   - Answer: **False (Inheritance is not considered a transfer for tax purposes.)**
8. A gain from the sale of gold jewelry is treated as a capital gain.
   - Answer: **True**

1.10 LET US SUM UP

In this chapter, we learned that capital gain is the profit earned from the transfer of a capital asset, such as land, buildings, shares, or gold. This profit is considered income under the head "Capital Gains" and is taxable under the Income-tax Act, 1961. A capital asset refers to any kind of property—movable, immovable, tangible, or intangible—whether or not it is used in business or profession. However, items like personal belongings (except jewellery), stock-in-trade, and certain rural agricultural land are not considered capital assets for taxation purposes.

We also studied that capital assets are classified as short-term or long-term based on the period of holding. Generally, an asset held for not more than 36 months is a short-term capital asset, whereas one held for more than 36 months is a long-term capital asset. However, for listed shares, mutual fund units, and certain securities, the holding period is just 12 months to qualify as long-term.

The term "transfer" includes sale, exchange, relinquishment, or compulsory acquisition of a capital asset. However, some transactions—like inheritance, gifts, or transfers between certain companies—are not treated as transfers and are exempt from capital gains tax. Short-term capital gains are usually taxed at normal income tax rates, while long-term capital gains attract a 20% tax rate along with indexation benefits to adjust for inflation.

Overall, this chapter helped us understand what capital gains are, how capital assets are defined and classified, and how transfers are treated for tax purposes. This foundational knowledge will be very useful as we move on to learn how to calculate capital gains and explore exemptions available under various sections like 54, 54B, 54F, and others in the coming chapters.

1.11 KEYWORDS

CAPITAL GAIN - Sections 45 to 55A of the Income-tax Act, 1961 deal with capital gains. Section 45 of the Act, provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, 54GA and 54H be chargeable to income-tax under the head "Capital Gains" and shall be deemed to be the income of the previous year in which the transfer took place.

CAPITAL ASSEST - Section 2(14) of the Income-tax Act defines the term "capital asset" to means Property of any kind held by an assessee whether or not connected with his business or profession but does not include any stock-in-trade, personal effects , agricultural land in India, 6½ per cent Gold Bonds, Special Bearer Bonds , Gold Deposit Bonds.

SHORT – TERM CAPITAL GAIN - The essential requirement for the incidence of tax on capital gains is the transfer of a 'capital asset'.· Any capital gain arising as a result of transfer of a short-term capital asset is known as short-term capital gain. "Short term" capital asset means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. In the case of capital assets (being equity or preference share in a company) held by an assessee for not more than 12 months immediately prior to its transfer.

LONG – TERM CAPITAL GAIN - Assets other than short-term capital assets are known as 'long-term capital assets' and the gains arising there from are known as 'long-term capital gains'. Section 48 of the Act provides that the income chargeable under the head 'capital gains' shall be computed by deducting from the full value of consideration received or accruing as a result of the transfer of the capital asset the f amount of expenditure incurred wholly and exclusively in connection with such transfer and the cost of acquisition of the capital asset and the cost of any improvement thereto.

1.12 SELF ASSESSMENT QUESTIONS

1. What do you mean by "Capital Gain"?

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2. Difference between Long-term Capital Gain and Short –Term Capital Gain.

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3. What are ‘capital assets’? What items are not included in capital assets?

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1. 13 LESSON END EXERCISE

1. What is the difference between a short-term and a long-term capital asset?

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2. Name any two types of transactions that are not treated as ‘transfer’ for capital gains tax.

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3. How does the holding period affect the computation and taxation of capital gains for different types of assets?

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1.14 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; Pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

COMPUTATION OF CAPITAL GAINS AND INDEXATION

STRUCTURE

2.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Learn the steps involved in calculating capital gains, including the calculation of full value of consideration, cost of acquisition, and cost of improvement.
- Grasp the concept of indexed cost of acquisition and indexed cost of improvement and how the Cost Inflation Index (CII) is used to adjust for inflation in the computation of capital gains.
- Understand how to compute capital gains in the case of a slump sale and the distinction between long-term and short-term capital gains based on the holding period.
- Recognize the types of expenditure incurred during the transfer of a capital asset that can be deducted from the sale proceeds while calculating capital gains

Learning outcomes

- Correctly apply the Cost Inflation Index (CII) to compute the indexed cost of acquisition and indexed cost of improvement, for assets,
- Apply the specific provisions of Section 50B to compute capital gains arising from a slump sale, including identifying the holding period and computing gains as either long-term or short-term.

- Identify what constitutes expenditure on transfer and correctly apply it when calculating the capital gains, including brokerage, commission, legal fees, stamp duty, etc.
- Understand the impact of the discontinuation of indexation benefits (from July 23, 2024) and make calculations based on the new provisions

2.1 INTRODUCTION

Capital gains are the profits earned from the sale or transfer of a capital asset such as land, buildings, stocks, bonds, and other financial instruments. In India, capital gains are categorized into short-term and long-term, based on the duration for which the asset is held before its transfer. The Income Tax Act, 1961, provides a detailed framework for computing capital gains, which involves determining the full value of consideration, cost of acquisition, cost of improvement, and adjusting for inflation through the Cost Inflation Index (CII). When calculating capital gains, several factors influence the final amount of tax payable, including the cost of acquisition, the cost of improvement, and any expenditure incurred during the transfer. The indexation benefit plays a crucial role in reducing taxable gains by adjusting the cost of acquisition and improvement of an asset based on inflation over time.

2.2 THE METHOD OF COMPUTING CAPITAL GAINS

Short-term Capital Gain	**Long-term Capital Gain**
A. Find out Full Value of Consideration	A. Find out Full Value of Consideration
B. Deduct	B. Deduct
(i) Expenditure incurred wholly and exclusively in connection with such Transfer. (ii) Cost of Acquisition (iii) Cost of Improvement (iv) Exemption provided by Ss. 54B, 54D & 54G,54GA	(i) Expenditure incurred wholly and exclusively in connection with such Transfer. (ii) Indexed Cost of Acquisition (iii) Indexed Cost of Improvement (iv) Exemption provided by Ss. 54, 54B, 54D, 54EC, 54ED, 54F & 54G, 54GA
C. (A-B) is the short-term capital gain	C. (A-B) is the long-term capital gain

2.3 FULL VALUE OF CONSIDERATION

Full value of consideration means the whole or complete sale price or exchange value or compensation including enhanced compensation received in respect of capital asset in transfer. The following points are important to note in relation to full value of consideration.

1. The consideration may be in cash or kind.

2. The consideration received in kind is valued at its fair market value.

3. It may be received or receivable.

4. The consideration must be actual irrespective of its adequacy.

When shares, debentures or warrants are received under employees stock option plan or scheme are transferred under a gift or an irrecoverable trust , the market value on the date of transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer for computation of capital gains.

CHECK YOUR PROGRESS

ONE WORD ANSWER

What is the term used for the profit earned from the sale of a capital asset?

Answer: Capital Gains

Which index is used to adjust the cost of acquisition for inflation?

Answer: Cost Inflation Index (CII)

What is the term for the expenses incurred to transfer a capital asset?

Answer: Expenditure on Transfer

What is the period required for an asset to qualify as a long-term capital asset?

Answer: 36 months

What is the cost of acquisition of an asset acquired under a gift or will?

Answer: Cost to the previous owner

Which capital gain tax rate applies if the asset is sold without indexation benefits after July 23, 2024?

Answer: 12.5%

2.4 COST OF ACQUISITION

Cost of Acquisition (COA) means any capital expense at the time of acquiring capital asset under transfer, i.e., to include the purchase price, expenses incurred up to acquiring date in the form of registration, storage etc. expenses incurred on completing transfer. In other words, cost of acquisition of an asset is the value for which it was acquired by the assessee. Expenses of capital nature for completing or acquiring the title are included in the cost of acquisition.

- **Cost to the previous owner deemed to be the cost of acquisition:** If the asset is acquired by an assessee in the *following* 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.

1. On any distribution of asset on the total or partial partition of a HUF or

2. Under gift or will

3. By succession, inheritance or devolution or

4. **Before 1st April 1987**, the distribution of capital assets on the **dissolution of a firm, BOI, or AOP** was **not treated as a transfer** and hence not chargeable to capital gains tax. However, from **1st April 1987** onwards (i.e., A.Y. 1988–89), such distribution is treated as a **transfer under Section 45(4)** and is **liable to capital gains tax.**

5. On Any distribution of asset on the liquidation of a company or

6. Under a transfer to a revocable or an irrevocable trust or

7. On transfer by a parent company to its Indian subsidiary company which is wholly owned by a parent company or

8. On the transfer by a subsidiary company to its Indian holding company which owns whole of the share capital of the subsidiary company or

9. On the transfer of capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company. Or

10. On transfer of shares of an Indian company by amalgamated foreign company to the amalgamated foreign company. Or

11. On the transfer of capital asset in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the central government or

12. When any members of HUF converts his self acquired property into HUF property or

13. On transfer of capital asset by the predecessor cooperative bank to the successor cooperative bank in a business organization or

14. On transfer of shares in the predecessor cooperative bank in lieu of shares allotted in the successor cooperative bank in a business reorganization or

15. On transfer of capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company or

16. On succession of a sole proprietary concern by a company.

- **Cost of share or security -** If a **share or security was acquired before 1st April 2001**, the **Cost of Acquisition** will be:

- Higher of: (a) Actual cost, or (b) FMV as on 1st April 2001\text{Higher of: (a) Actual cost, or (b) FMV as on 1st April 2001}Higher of: (a) Actual cost, or (b) FMV as on 1st April 2001
- The assessee can choose whichever is **more beneficial**.
- FMV should be **determined as per prescribed methods** (especially for listed securities).

- **Cost of bonus shares**

a) Bonus Shares Allotted Before 1st April 2001:

- Cost of acquisition = **FMV as on 1st April 2001**

b) Bonus Shares Allotted On or After 1st April 2001:

- Cost of acquisition = **Nil** (since no consideration was paid)

- **Cost of acquisition of goodwill** If the asset is purchased from the previous owner – purchase price In any other case – Nil
- **Right issue**-cost of acquisition in the case of right issue is amount actually paid to acquire it.
- **Capital asset acquired before 1st April 2001**

  ➤Cost of acquisition = Higher of:

  (a) Actual cost to the assessee
  (b) FMV as on **1st April 2001**

- **Capital asset acquired by the previous owner before 1st April 2001** (e.g., through gift, will, inheritance, etc.)

  ➤Cost of acquisition = Higher of:

  (a) Cost to the **previous owner**
  (b) FMV as on **1st April 2001**

- **Cost of acquisition of shares or debentures**- shares or debentures acquired in consideration of conversion of debenture, debenture stock or deposit certificate shall be deemed to be the cost of original debentures, debenture stocks or deposit certificates converted.

Cost of acquisition shall have to be adjusted by the Cost Inflation Index to arrive at the indexed cost of acquisition, as follows:

For assets acquired before 1st April 2001 (Earlier it was 1st April 1981)

> **Note**: As per the amendment in the Finance Act, 2017, for capital assets acquired before **1st April 2001**, the **Fair Market Value (FMV)** as on **1st April 2001** can be considered as the **Cost of Acquisition** instead of actual cost.

$$\textbf{Indexed Cost of Acquisition} = \textbf{(FMV or Actual Cost (whichever is higher))} * \frac{\textbf{CII of Year of transfer}}{\textbf{CII OF 2001 – 2002}}$$

For assets acquired on or after 1st April 2001

$$\textbf{Indexed Cost of Acquisition} = \textbf{Actual Cost} \times \frac{\textbf{CII of Year of Acquisition}}{\textbf{CII of Year of Transfer}}$$

<u>Discontinuation of Indexation Benefit</u>

As of July 23, 2024, the government has discontinued the indexation benefit on long-term capital gains. This means that investors can no longer adjust the purchase price of their investments for inflation when calculating capital gains for tax purposes. Consequently, long-term capital gains will be computed based on the actual purchase price, potentially resulting in higher taxable gains and, therefore, a higher tax liability for investors. However, in case of transfer of land or building acquired before July 23, 2024, taxpayers have the option to pay tax at either a rate of 12.5% without indexation benefits or 20% with indexation benefits. However, on land or building purchased on or after 23rd July, 2024, the tax rate will be 12.5% without indexation benefit, applicable to assets qualified as long term.

2.5 COST OF IMPROVEMENT

Cost of improvement is the capital expenditure incurred by an assessee for making any addition or improvement in the capital asset. It also includes any expenditure incurred in protecting or curing the title. In other words, cost of improvement includes all those expenditures, which are incurred to increase the value of the capital asset.

$$\textbf{Indexed Cost of improvement} = \frac{\textbf{Cost of improvement x CII for the year in which the asset is sold}}{\textbf{CII for the year in which the improvement to asset took place}}$$

Any cost of improvement incurred before 1st April 2001 is ignored for the purpose of computing capital gains.

The reason is that if an asset was acquired before 1st April 2001, the assessee has the option to consider the fair market value (FMV) as on 1st April 2001 as the cost of acquisition.

This FMV would already reflect any improvements made to the asset prior to that date.

Therefore, including such pre-2001 improvements again would result in double counting.

CHECK YOUR PRGRESS

Multiple Choice Questions (MCQs)

1. **What is the key factor for determining the classification of capital gains as short-term or long-term?**
   - a) The type of asset
   - b) The cost of acquisition
   - c) The holding period of the asset
   - d) The market value of the asset

   Answer: c) The holding period of the asset

2. **Which of the following is considered the 'Full Value of Consideration'?**
   - a) The market value of the asset
   - b) The total sale price received
   - c) The acquisition cost of the asset
   - d) The cost of improvement

   Answer: b) The total sale price received

3. **Which of the following assets is eligible for indexation under the Income Tax Act, 1961?**
   - a) Short-term capital assets
   - b) Fixed deposits
   - c) Long-term capital assets
   - d) Both short-term and long-term capital assets

   Answer: c) Long-term capital assets

4. **Which section of the Income Tax Act deals with the computation of capital gains in the case of slump sale?**
   - a) Section 45
   - b) Section 50B
   - c) Section 54
   - d) Section 48

   Answer: b) Section 50B

2.6 COST INFLATION INDEX

COST INFLATION INDEX SPECIFIED PURPOSE OF COMPUTATION OF CAPITAL GAIN

In exercise of the powers conferred by clause (v) of the Explanation to Section 48 of the Income-tax Act, 1961 (43 of 1961), the Central Government; having regard to seventy-five per cent of the average rise in the Consumer Price Index for urban non-manual employees, has specified the Cost Inflation Index as mentioned in column (3) of the Table below for the financial year mentioned in the corresponding entry in column (2) of the said Table.

Sl. No.	**Financial year**	**Cost Inflation Index**
(1)	**(2)**	**(3)**
1.	**2000-01**	**100**
2+.	**2001-02**	**105**
3.	**2002-03**	**109**
4.	**2003-04**	**113**
5.	**2004-05**	**117**
6.	**2005-06**	**122**
7.	**2006-07**	**129**
8.	**2007-08**	**137**
9.	**2008-09**	**148**
10.	**2009-10**	**167**
11.	**2010-11**	**184**
12.	**2011-12**	**184**
13.	**2012-13**	**200**
14.	**2013-14**	**220**
15.	**2014-15**	**240**
16.	**2015-16**	**254**
17.	**2016-17**	**264**
18.	**2017-18**	**272**
19.	**2018-19**	**280**
20.	**2019-20**	**289**
21.	**2020-21**	**301**
22.	**2021-22**	**317**
23.	**2022-23**	**331**
24.	**2023-24**	**348**
25.	**2024-25**	**363**

A Cost Inflation Index table is used to calculate the long-term capital gains from a capital asset transfer or sale. The profit earned through the sale or transfer of any capital asset, such as land, property, stocks, shares, trademarks, patents, and so on, is referred to as capital gain.

Long-term capital assets are typically documented in books at their cost price. As a result, despite growing asset prices, these capital assets cannot be revalued.

When these assets are sold, the profit or gain obtained from them remains high due to their high sale price in relation to their acquisition price. As a result, assessees must pay a greater income tax on these assets' gains.

In the long run, the application of the Cost Inflation Index for capital gain adjusts the purchase price of assets based on their sale price, resulting in smaller earnings and a lower tax amount.

Computation of capital gains in case of slump sale: Any gain arising from a slump sale during the previous year is chargeable to capital gains tax in the year of transfer.

Under **Section 50B** of the Income Tax Act, the gain from a **slump sale** is treated as:

- **Long-term capital gain**, if the undertaking or division has been held for **more than 36 months**
- **Short-term capital gain**, if held for **36 months or less**

Expenditure on transfer

Expenditure incurred wholly and exclusively for transfer of capital asset is called expenditure on transfer. It is fully deductible from the full value of consideration while calculating the capital gain. Examples of expenditure on transfer are the commission or brokerage paid by seller, any fees like registration fees, and cost of stamp papers etc., travelling expenses, and litigation expenses incurred for transferring the capital assets are expenditure on transfer.

Note: Expenditure incurred by buyer at the time of buying the capital assets like brokerage, commission, registration fees, cost of stamp paper etc. are to be added in the cost of acquisition before indexation.

2.7 LET US SUM UP

The computation of capital gains and the application of indexation are essential aspects of tax planning for individuals and businesses alike. The key to accurate capital gains calculation lies in understanding the different elements that contribute to it—namely, the full value of consideration, cost of acquisition, cost of improvement, and expenditures incurred during the transfer.

The Cost Inflation Index (CII) plays a significant role in adjusting the cost of acquisition and improvement for inflation, ensuring that the capital gains are calculated in real terms, rather than inflated by the passage of time. This adjustment helps taxpayers minimize their tax liability by accounting for the effects of inflation over the years.

For short-term capital gains, the calculation involves the actual cost of acquisition and improvement, whereas for long-term capital gains, the indexation benefit is available, allowing for a more accurate reflection of the asset's real value at the time of sale.

As per the Income Tax Act, the rules governing capital gains taxation ensure that taxpayers pay a fair share of tax on profits earned from the sale of assets, while also providing mechanisms to mitigate the impact of inflation through indexation.

CHECK YOUR PROGRESS

Fill in the Blanks

1. The profits arising from the sale of capital assets are known as ____________.
2. A capital asset is classified as ____________ if it is held for a period of more than 36 months.
3. The process of adjusting the cost of acquisition and improvement based on inflation is called ____________.
4. The ____________ is used to adjust the cost of acquisition and improvement for inflation.
5. If a capital asset is acquired before 1st April 2001, the higher of ____________ or the Fair Market Value (FMV) as of 1st April 2001 is considered as the cost of acquisition.
6. The ____________ is deducted from the full value of consideration to compute capital gains.
7. If an asset is sold before the completion of ____________ months, the gain is classified as short-term capital gain.
8. Expenditure incurred on commission, registration fees, or stamp paper is known as ____________.
9. The ____________ benefit has been discontinued as of July 23, 2024, for long-term capital gains in India.
10. For assets acquired before 1st April 1981, the cost of acquisition is considered as the ____________ or FMV on 1st April 1981.

Answers:

1. **Capital Gains**
2. **long-term**
3. **Indexation**
4. **Cost Inflation Index (CII)**
5. **Actual Cost**
6. **Expenditure on Transfer**
7. **36**
8. **Expenditure on Transfer**
9. **Indexation**
10. **FMV**

2.8 KEYWORDS

Cost of Acquisition: The original purchase price of the asset plus acquisition-related costs.

Cost of Improvement: Capital expenditure incurred to enhance or improve the asset.

Expenditure on Transfer: Costs incurred in the process of transferring the asset (brokerage, legal fees, etc.).

Indexed Cost of Acquisition: The acquisition cost adjusted for inflation using the Cost Inflation Index.

Indexed Cost of Improvement: The improvement cost adjusted for inflation using the Cost Inflation Index.

Cost Inflation Index (CII): An index used to adjust the cost of acquisition and improvements for inflation, published annually by the government.

2.9 SELF ASSESSMENT QUESTIONS

1. Explain the concept of full value of consideration with an example.

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2. How would you compute the indexed cost of acquisition for an asset acquired before 1st April 2001?

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3. What is the role of the Cost Inflation Index in calculating capital gains?

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2.10 LESSON END EXERCISE

1. Compute the capital gains (both short-term and long-term) for the sale of a capital asset, considering the relevant full value of consideration, cost of acquisition, and cost of improvement.

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2. Calculate the indexed cost of acquisition and capital gains for a property acquired before 1st April 2001 and sold in 2023.

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3. What is Cost of Acquisition and Cost of Improvement?

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2.11 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

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7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

EXEMPTIONS OF CAPITAL GAIN

STRUCTURE

3.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Identify the different sections under the Income Tax Act that provide exemptions from capital gains tax.
- Recognize the eligible assessees and conditions under each section for capital gain exemptions.
- Learn the provisions under Section 54, Section 54B, Section 54D, Section 54EC, Section 54EE, Section 54F, Section 54G, and Section 54GA.
- Understand the criteria for each exemption, including the nature of the asset, time frame, and the new investment requirement.

Learning outcomes

- Define and describe the provisions under Sections 54, 54B, 54D, 54EC, 54EE, 54F, 54G, and 54GA with clarity.

- Correctly apply the conditions of exemption for capital gains under each section, including time frames for new investments and specific use of assets.
- Accurately calculate the exemption under each provision, considering factors such as capital gains and the cost of the new asset purchased
- Understand the function of CGAS and how to properly utilize it when capital gains are not utilized within the required time frame.

3.1 INTRODUCTION

Capital gains tax is levied on the profit earned from the transfer of capital assets, such as property, stocks, or bonds. However, the Income Tax Act, 1961 provides certain exemptions that allow taxpayers to reduce or eliminate the capital gains tax liability under specific conditions. These exemptions are primarily designed to encourage investments in key sectors such as real estate, agriculture, and industry, and to promote economic growth and mobility of assets.

Exemptions under capital gains tax can significantly benefit individuals and Hindu Undivided Families (HUFs) by offering relief on the transfer of assets used for residential purposes, agricultural land, industrial undertakings, and investments in specified bonds or funds. Each section of the Income Tax Act that provides these exemptions outlines specific conditions that must be met in order to qualify for relief. These conditions can include time frames for reinvestment, the nature of the assets, and the intended use of the new assets purchased.

Understanding these exemptions is crucial for taxpayers looking to minimize their tax liability while making informed decisions about the transfer of assets. Sections 54, 54B, 54D, 54EC, 54EE, 54F, 54G, and 54GA are among the key provisions that offer such exemptions, each designed to address different types of capital gains and the reinvestment options available to the taxpayer.

3.2 EXEMPTIONS FROM CAPITAL GAINS

3.2.1 Capital gain arising on the transfer of property used for residence u/s Section 54:

1. Eligible Assessee:

Exemption is available only to individuals and Hindu Undivided Families (HUFs) ,

2. Eligible Asset:

The asset transferred must be a residential house property, and it must be a long-term capital asset (i.e. held for more than 24 months prior to transfer).

3. Utilization of Capital Gains:

Exemption under Section 54 is available if:

- A new residential house is purchased within 1 year before or 2 years after the date of transfer, or

- A new residential house is constructed within 3 years from the date of transfer.
- The date of commencement of construction is not relevant; only completion within 3 years is required.

4. Capital Gain Account Scheme (CGAS):

If the capital gains are not utilized before the due date of filing the return, the unutilized amount must be deposited under the Capital Gain Account Scheme, 1988.

5. Amount of Exemption:

Exemption under Section 54 is the lower of:

- The amount of capital gain, or
- The cost of the new residential house property.

6. Withdrawal/Revocation of Exemption:

- If the new house is sold within 3 years, the exemption is withdrawn, and the earlier exempted capital gain becomes taxable in the year of sale.
- The cost of acquisition of the new house will be reduced by the exempted amount, resulting in higher capital gains.

7. Short-Term Capital Gains (STCG) on New Property:

If the new property is sold within 3 years, the gain becomes short-term and is taxed at normal slab rates, which can be as high as 30% for individuals in the highest bracket.

3.2.2 Capital gain arising from the transfer of agricultural land (Section 54 B)

1. Applicability:

Section 54B provides exemption from capital gains tax on the transfer of agricultural land used for agricultural purposes, subject to certain conditions.

2. Eligible Assessee:

Only Individual or Hindu Undivided Family (HUF) can claim the exemption.

3.Key Conditions for Exemption:

a).Nature and Use of Transferred Land:

The land transferred must be agricultural land.

It must have been used for agricultural purposes by:

The assessee, or

In the case of an individual, his parent, or

In the case of an HUF, any member of the HUF.

Such use must have occurred for at least 2 years immediately preceding the date of transfer.

b).Type of Land:

The exemption applies only when the transferred land is a capital asset.

Rural agricultural land is not a capital asset under Section 2(14)(iii); hence, no capital gain arises on its transfer.

Therefore, Section 54B applies primarily to urban agricultural land.

c).Reinvestment in Agricultural Land:

The assessee must purchase another agricultural land (rural or urban) within 2 years from the date of transfer.

The new land must also be used for agricultural purposes.

d).Capital Gain Account Scheme (CGAS):

If the amount of capital gain is not fully utilized for purchase before the due date for filing the return of income, the unutilized amount must be deposited in a Capital Gains Account Scheme, 1988, to claim exemption.

4. Amount of Exemption:

The exemption available under Section 54B will be the lower of:

The amount of capital gain, or

The cost of the new agricultural land purchased.

5. Withdrawal of Exemption:

If the newly acquired agricultural land is transferred within 3 years of its purchase, the exemption earlier claimed will be withdrawn.

The exempted capital gain will be taxable in the year in which the new land is sold.

6. Important Notes:

The use of the land for agriculture is critical; ownership alone is not sufficient.

Only one parent (mother or father) using the land is enough for satisfying the condition in case of individuals.

The exemption applies even if the new land purchased is rural or urban, as long as it is used for agriculture.

3.2.3 Capital gains on compulsory acquisition of land and buildings used in an industrial undertaking (Section 54 D):

1. Applicability:

Exemption is available to all categories of taxpayers on capital gains arising from compulsory acquisition of land/building used for industrial purposes.

2. Conditions for Exemption:

- The asset transferred is land, building, or any right in land or building.
- The asset must have been used by the assessee's industrial undertaking for at least 2 years immediately before the date of compulsory acquisition.
- The transfer must be by way of compulsory acquisition under any law.
- The assessee must purchase any other land/building, or construct a building for industrial use within 3 years from the date of receipt of compensation.

3. Amount of Exemption:

The amount of capital gain will be exempt to the extent of the cost of the new asset acquired for industrial use.

4. Capital Gains Account Scheme:

If the capital gains are not fully utilized by the due date for filing return of income, the unutilized amount must be deposited in the Capital Gains Account Scheme, 1988.

5. Withdrawal of Exemption:

If the new asset is transferred within 3 years of its acquisition:

- The exemption earlier claimed will be withdrawn.
- The cost of acquisition of the new asset will be reduced by the amount of exemption claimed, resulting in higher capital gain on transfer.

CHECK YOUR PROGRESS

One Word Answers:

1. The scheme where unutilized capital gains can be deposited to claim exemption –

   ➤**CGAS**

2. The maximum amount that can be invested in Section 54EC bonds per financial year –

   ➤**50 lakh**

3. Asset type required to claim exemption under Section 54B –

   ➤**Agricultural land**

4. Exemption section applicable for reinvestment in residential property when the original asset was not a house –

   ➤**54F**

5. The government body that issues specified bonds under Section 54EC –

   ➤**NHAI / REC**

3.2.4 Investment in Financial Assets (Section -54 EC): Section 54EC of the Income-tax Act, 1961 deals with exemption on long-term capital gains when invested in certain specified bonds.

1. Applicability:

Available to all categories of taxpayers on long-term capital gains arising from the transfer of a capital asset.

2. Conditions for Exemption:

- The assessee must transfer a long-term capital asset during the previous year.
- The whole or part of the capital gain must be invested in specified bonds within 6 months from the

date of transfer.

- These bonds are redeemable after 5 years

3. Specified Bonds (Section 54EC Bonds):

The bonds must be:

- Issued on or after 1st April 2007, and
- Redeemable after 5 years (for investments made on or after 1st April 2018).

Issued by:

- National Highways Authority of India (NHAI), or
- REC Limited (formerly Rural Electrification Corporation Limited)

No deduction under Section 80C is allowed for investment in Section 54EC bonds

4. Investment Limit:

Maximum investment eligible for exemption is ₹50 lakh in a financial year.

5. Lock-in & Restrictions:

- ➢ The bonds must not be transferred, converted into cash, or used as security for a loan or advance for a period of 5 years from the date of acquisition.
- ➢ If this condition is violated:
- The exemption is withdrawn, and
- The amount earlier claimed as exempt will be taxed as capital gain in the year of such transfer or conversion.

3.2.5 Investment in units of a specified fund (Section 54EE)

1. Eligible Assessee: Any Assessee
2. Type of asset transferred: Long-term Capital Asset
3. Type of transfer: Long-term Capital Asset
4. New Asset Purchased: Units notified by the Central Government
5. Time limit for new investment: Within 6 months from the date of the transfer
6. Exemption Amount: Cost of new asset x Capital Gain / Net consideration (maximum up to capital gain)
7. CAGS: No
8. Additional Condition:

- If a new asset is sold within 5 years (3 years before F.Y. 2018-19), the amount earlier exempted under this section will be reduced from its COA to calculate capital gains thereon
- If a loan is taken on the security of the new specified asset within 5 years, the same will be treated as capital gains
- Investment in specified bonds should not exceed Rs.50 lakh during the current and succeeding fiscal year

3.2.6 Investment into a residential house (Section 54F):

1. Applicability:

- Available to Individual or HUF only.
- Capital gain must arise from the transfer of any long-term capital asset, other than a residential house.
- The assessee must invest the net consideration in purchase or construction of a residential house property in India.

2.Conditions to Claim Exemption:

- The assessee should not own more than one residential house (other than the new one being acquired) on the date of transfer.
- The assessee should not purchase another residential house within 1 year, or construct another house within 3 years after the date of transfer.

3.Amount of Exemption:

$$\textbf{Amount of exemption} = \frac{\textbf{Cost of New House X Capital Gains}}{\textbf{Net Consideration}}$$

Where net consideration = full value of consideration - cost of transfer.

4. Capital Gains Account Scheme:

If the investment is not made before the due date of filing ITR, the unutilized amount must be deposited in the Capital Gains Account Scheme, 1988.

5.Consequences of Violation:

If the assessee:

- Purchases another house within 1 year, or
- Constructs another house within 3 years,

Then:

- The exemption allowed earlier shall be revoked, and
- The amount exempted shall be taxed as long-term capital gain in the year of such purchase/construction

CHECK YOUR PROGRESS

Match the Columns

Column A	**Column B**
1. Section 54F	a. Shift industrial unit to SEZ
2. Section 54B	b. Long-term asset other than residential
3. Section 54GA	c. Agricultural land
4. Section 54EC	d. Residential house (original and new)

Column A	Column B
5. Section 54	e. Specified Bonds (NHAI/REC)
6. Section 54G	f. Shift industrial unit to rural/SEZ area

ANSWER: 1-b, 2-c, 3-a, 4-e, 5-d, 6-f

3.2.7 Shifting of industrial undertaking from urban to rural areas (Section 54G)

1.Eligible Assessee: Any assessee

2.Type of asset transferred: Capital assets are plant, machinery, land, buildings or rights in land or buildings that are used in an industrial undertaking situated in an urban area

3.Type of transfer: Long-term or Short-term Capital Asset

4.New Asset Purchased: Shifting of an industrial undertaking to an area other than an urban area to a rural or SEZ area involving:

- Purchase of new plant/machinery
- Acquisition of land or construction of a building
- Shifted the old asset and transferred the undertaking to a new area
- Incurred specified expenses

5. Time limit for new investment: 1 year before and 3 years after the date of transfer

6. Exemption Amount: Long-Term Capital Gain OR Cost of new asset, whichever is lesser

7. CAGS: Yes - deposit by the return filing due date

8. Additional Condition:

- If a new asset is sold within 3 years, the amount previously exempted under this section will be reduced from its COA to calculate capital gains thereon.
- If the amount in CGAS is not utilised within the prescribed time limit, such unutilised amount will be taxable as capital gains

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3.2.8 Shifting of industrial undertaking from an urban area to SEZ (Section 54GA)

1. Eligible Assessee: Any assessee

2. Type of asset transferred: Capital assets are plant, machinery, land, buildings or rights in land or buildings that are used in an industrial undertaking situated in an urban area

3. Type of transfer: Long-term or Short-term Capital Asset

4. New Asset Purchased: Shifting of an industrial undertaking to an area other than an urban area to a rural or SEZ area involving:

Purchase of new plant/machinery

Acquisition of land or construction of a building

Shifted the old asset and transferred the undertaking to a new area

Incurred specified expenses

5. Time limit for new investment: 1 year before and 3 years after the date of transfer
6. Exemption Amount: Long-Term Capital Gain OR Cost of new asset, whichever is lesser
7. CAGS: Yes - deposit by the return filing due date
8. Additional Condition:
   - If a new asset is sold within 3 years, the amount previously exempted under this section will be reduced from its COA to calculate capital gains thereon.
   - If the amount in CGAS is not utilised within the prescribed time limit, such unutilised amount will be taxable as capital gains.

3.3 LET US SUM UP

Capital gains exemptions under various sections of the Income Tax Act provide valuable opportunities for taxpayers to reduce their tax burden and reinvest in new assets, thereby stimulating economic growth. By offering relief on the transfer of residential properties, agricultural land, industrial assets, and investments in financial instruments, the provisions under Sections 54, 54B, 54D, 54EC, 54EE, 54F, 54G, and 54GA serve as key tools for individuals and Hindu Undivided Families (HUFs) to optimize their tax liabilities.

However, to benefit from these exemptions, it is essential for taxpayers to understand and comply with the specific conditions outlined in each section. This includes adhering to time frames for reinvestment, ensuring that the new assets meet the prescribed requirements, and utilizing the Capital Gains Account Scheme (CGAS) when necessary. Failure to follow these guidelines can result in the withdrawal of exemptions and the reimposition of capital gains tax, which could significantly increase tax liabilities.

By mastering the details of these exemptions, taxpayers can make informed decisions regarding their investments, plan asset transfers effectively, and avoid unnecessary tax penalties. In doing so, they can take full advantage of the opportunities available under the Income Tax Act, leading to both financial savings and strategic growth.

In summary, capital gains exemptions are a powerful tool for managing tax liabilities, but careful attention to the rules and conditions is essential to ensure compliance and maximize the potential benefits. With this knowledge, individuals and HUFs can navigate the complexities of the tax system and make the most of their capital gains.

CHECK YOUR PROGRESS

True or False:

1. **Section 54** exemption is available only to companies and LLPs.

   ➢**False**
2. Capital gains on urban agricultural land can be exempted under **Section 54B**.

   ➢**True**
3. The Capital Gains Account Scheme (CGAS) is optional when the capital gains are not reinvested before return filing.

   ➢**False**
4. Under **Section 54EC**, bonds are redeemable after 3 years.

   ➢**False**
5. If the new residential property is sold within 3 years, exemption under Section 54 is withdrawn.

   ➢**True**
6. Section 54EE allows investments in any mutual fund for exemption.

   ➢**False**
7. Exemption under Section 54F is not available if the assessee owns more than one house on the date of transfer.

   ➢**True**

3.4 KEYWORDS

Exemption: A provision that allows taxpayers to reduce or eliminate their tax liability by meeting certain conditions specified under the Income Tax Act.

Section 54: A provision in the Income Tax Act that provides exemption from capital gains tax on the sale of residential property, provided the gain is used to purchase or construct a new residential property.

Section 54B: A provision that offers capital gains exemption on the sale of agricultural land, subject to the condition that the gains are reinvested in purchasing new agricultural land within 2 years.

Section 54D: An exemption provision for capital gains arising from the compulsory acquisition of land or buildings used for industrial purposes, provided the gains are reinvested in acquiring similar assets for industrial use.

Section 54EC: Exemption on long-term capital gains if the gains are invested in specified bonds (such as NHAI or REC bonds) within 6 months from the date of transfer. The bonds are redeemable after 5 years.

Section 54EE: Provides an exemption on long-term capital gains if the gains are invested in specified units of a fund notified by the government, subject to a cap of ₹50 lakh.

Section 54F: Offers capital gains exemption for the sale of any long-term capital asset (other than a residential house), provided the net sale proceeds are invested in a new residential property.

Section 54G: An exemption for capital gains arising from the transfer of industrial assets (like machinery or land) when the assets are shifted from an urban area to a rural area or Special Economic Zone (SEZ).

Section 54GA: Provides an exemption on capital gains for the transfer of industrial assets when the assets are shifted from an urban area to a Special Economic Zone (SEZ), subject to certain conditions.

3.5 SELF ASSESSMENT QUESTIONS

1. What is the maximum amount that can be invested in Section 54EC bonds in one financial year?

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2. Write a short note on Section 54B and Section 54 F.

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3. Explain the difference between exemptions under Section 54 and Section 54F of the Income Tax Act. What are the key eligibility criteria for each?

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3.6 LESSON END EXERCISE

1. Explain the conditions for claiming exemption under Section 54 of the Income Tax Act.

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2. Name any two bonds eligible for exemption under Section 54EC.

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3. Explain the concept exemption of capital gains.

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3.7 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

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4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

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6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; Pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

INCOME FROM OTHER SOURCES

STRUCTURE

4.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand the scope of Income from Other Sources under the Income Tax Act.
- Identify specific and general incomes chargeable under this head.
- Learn what expenses are deductible and which are inadmissible.
- Learn to compute income under this head with examples and real-life scenarios.

Learning outcomes

- Ability to differentiate between taxable and exempt incomes under this head.
- Ability to apply Section 56(1) and 56(2) for classifying income correctly.
- Ability to compute the taxable income from other sources after allowable deductions

4.1 INTRODUCTION

The Income Tax Act broadly classifies income under these heads: salary, house property, business or profession, and capital gains. However, certain types of income do not fit into these categories. Such income is taxed under the head ‘Income from Other Sources’ as per Section 56 of the Act.

This is a residuary category that includes earnings like interest on savings, fixed and recurring deposits, lottery winnings, gifts, and certain types of rental income. Casual income like lottery, income from horse race winnings, etc are taxed at 30%. Other incomes like bank interest are taxed under the respective slab rates.

4.2 MEANING OF INCOME FROM OTHER SOURCES

“Income from other sources” is the fifth and last head of income included while computing the gross total income of an assessee. Under the Income Tax act, income of every kind which is not to be excluded from the total income shall be chargeable to income tax under the head 'Income from other sources', if it is not chargeable to income tax under any of the other heads of income. Thus, income from other sources is a residuary head of income i.e. income not chargeable under any other head is chargeable to tax under this head. All income other than income from salary, house property, business and profession or capital gains is covered under 'Income from other sources'

Section 56, 57, 58 and 59 of the Income Tax Act deal with the computation of income under this head.

According to section 56 (1), every kind of income which is included in the total income under this Act and which is not charged to tax under any first four heads specified in section 14 is chargeable to income-tax under the head “ Income from Other Sources”.

There are two types of income included in this head

- General Incomes covered under section 56(1), and
- Specific Incomes covered under section 56(2).

CHECK YOUR PROGRESS

Multiple Choice Questions (MCQs)

1. Which of the following is not taxable under the head "Income from Other Sources"?
   a) Interest on bank fixed deposits
   b) Income from agriculture in India
   c) Lottery winnings
   d) Gifts received exceeding ₹50,000 from a non-relative
2. Under which section of the Income Tax Act is "Income from Other Sources" primarily dealt with?
   a) Section 14
   b) Section 56
   c) Section 44
   d) Section 80C

3. Income received as family pension is eligible for a standard deduction of:

   a) ₹50,000

   b) 50% of the pension

   c) Lower of ₹15,000 or 1/3rd of pension received

   d) ₹10,000 flat deduction

4. Which of the following incomes is specifically covered under Section 56(2)?

   a) Income from sub-letting

   b) Gift received without consideration exceeding ₹50,000

   c) Freelance writing by a non-journalist

   d) Director's remuneration

5. Interest on compensation or enhanced compensation is eligible for what % deduction?

   a) 100%

   b) 75%

   c) 50%

   d) 25%

Answers

1. b) Income from agriculture in India, **2. b)** Section 56, **3 .c).**Lower of ₹15,000 or 1/3rd of pension received, **4. b).**Gift received without consideration exceeding ₹50,000, **5. c).** 50%

4.3 GENERAL INCOMES SECTION 56 (1)

General Incomes section 56 (1) as 'Income from Other Sources'

1) Income earned by the assessee from licenses granted to brick-makers, to erect brickklins upon his land and making use of the brick-earth for making bricks.

2) Interest on loans, securities, deposits, cooperative debentures and current accounts.

3) Income from agriculture land situated outside India.

4) Income derived by a coal mine owner from rent and royalties.

5) Any withdrawal from the National Saving Scheme up to an amount on which deduction under section 80CCA has been claimed.

6) Remuneration received for being as a director, not as employee.

7) Income received from a person other than the employer like University remuneration.

8) Family pension received by the legal heirs of employee.

9) Income received by a professional man as a university examiner.

10) Income received from sub-letting of house.

11) Remuneration from lectures delivered outside India.

12) Tips received by a waiter or taxi driver not from their employer.

13) Any amount or pension received from LIC or other insurer under section 80CCC.

14) Deemed incomes.

15) Income from writing articles by a non-journalist.

17) Gratuity received by a non-employee director.

18) Commission received by an agent of Life Insurance Corporation, Postal Savings, Unit Trust of India or other type of mutual funds if it is not his regular business.

19) Commission received by a director for standing as a guarantor.

20) Commission received by a director for under righting the shares of a new company.

4.4 SPECIFIC INCOMES SECTION 56 (2)

Specific Incomes section 56 (2) as 'Income from Other Sources'

1) Any winning from lotteries, crossword puzzles, races including horse races, car games or any other games or from gambling or betting of any form or natural.

2) Dividends (except dividend covered u/s 115-O).

3) Income from plant, machinery or furniture let on hire, provided such income is not charged to tax under the head 'profits and Gains of Business or Profession'.

4) Any sum received by the assessee from his employees as contribution to any provident fund or superannuation fund or any fund set up under provisions of the Employees State Insurance Act 1948, o from any other fund from the welfare of such employees, provided such income is not charged to tax under the head 'Profits and Gains of Business or Profession'.

5) Income received in the form of interest on securities, provided such income is not charged to tax under the head 'Profits and Gains of Business or Profession.

6) Income from let-out of building along with plant, machinery or furniture and letout of building is

inseparable from such plant, machinery or furniture, provided income from such let-out is not charged to tax under the head ‘Profits and Gains from Business or Profession’.

7) Any sum or bonus received from key man insurance policy if such sum is not chargeable to tax as salary or bonus income.

8) Any sum of money received without consideration by an individual or HUF, the aggregate value of which exceeds Rs.50, 000, from any person on or after 1 April 2006 but before 1 October 2009. The whole amount will be charged to tax under the head ‘Income from Other Sources’.

9) Income received by in the form of interest on compensation or on enhanced compensation.

10) Any consideration received by a closely held company for the issue of shares that exceeded the face value of such shares.

11) Any sum received as an advance or otherwise in the course of negotiation for the transfer of a capital asset and such amount is forfeited due to non transfer of such capital asset.

12) if a firm or closely held company receives any property in the form of shares of a closely held company in any previous from any person: a) Without any consideration, the aggregate fair market value of which exceeds Rs.50,000, such aggregate fair market value of shares shall be taxable under the head ‘Income from Other Sources’. b) For a consideration which is less than the fair market value of such shares by an amount exceeding Rs. 50000, the excess of aggregate fair market value of such shares over such consideration shall be taxable under the head ‘Income from Other Sources’.

13) The treatment of Gifts by an Individual or HUF:

a) Any sum of money received by an individual or HUF from any person without consideration exceeds Rs.50000 in aggregate during the previous year, whole of such amount shall be chargeable to tax under the head ‘Income from other sources’.

b) Immovable property:

(i)- Any immovable property received by an individual or HUF from any person without any consideration having stamp duty exceeding Rs.50000, the stamp duty value shall be taxable under the head ‘Income from other sources’.

(ii)- Any immovable property received by an individual or HUF on or after 1 April 2014 for a consideration which is less than the stamp duty value of such property by an amount exceeding Rs. 50000, the stamp duty value of such property as exceeding such consideration is taxable under the head ‘Income from other sources’.

a) Other than Immovable Property;

(i)- Property other than immovable property received by an individual or HUF from any person without any consideration, the aggregate fair market value of which exceeds Rs.50000, whole of the aggregate fair market value of such property shall be taxable under the head ‘income from other sources’.

(ii)- Property other than immovable property received by an individual or HUF from any person for a consideration, which is less than the aggregate fair market value of the property by an amount exceeding Rs. 50000, the excess of aggregate fair market value of such property over such consideration is taxable under the head ‘Income from other sources’.

CHECK YOUR PROGRESS

Fill in the Blanks

1. Section ____ of the Income Tax Act governs income taxable under the head “Income from Other Sources”.
2. _________ income is taxed at a flat rate of 30% under this head.
3. If an individual receives a gift in the form of property worth ₹70,000 without consideration, the entire amount is ________.
4. The head “Income from Other Sources” is a ________ head of income.
5. Deduction allowed for family pension is the lower of ₹15,000 or ___________ of the actual pension received.

Answers:-

1. 56
2. Casual
3. Taxable
4. Residuary
5. One-third (1/3rd)

4.5 ADMISSIBLE DEDUCTIONS

EXPENSES ALLOWED TO BE DEDUCTED FROM CERTAIN INCOME SOURCES

Similar to freelancers and businesses who can deduct certain expenses from their income, a taxpayer earning income from other sources can claim deductions for expenses as given below:

- Expenses (not capital expenses) such as repairs, insurance premium, and depreciation in respect of plant, machinery, furniture and buildings are deductible from rental income earned by letting out of plant, machinery, furniture and building.

- A standard deduction is allowed on family pension income. The deduction is the lower of:
    - ₹15,000 (or ₹25,000 under the new tax regime), and
    - One-third of the actual family pension received.
- This applies to monthly pensions received by family members of a deceased employee.
- In case, interest on compensation or enhanced compensation is received, 50% of the interest is allowed to be deducted (applicable starting from the assessment year 2010-11).
- As per Section 57(iii), a deduction is allowed for any other expense (which is not a capital expense) which has been spent wholly and exclusively for making or earning such income.

4.6 INADMISSBLE DEDUCTIONS

EXPENSES NOT DEDUCTIBLE FROM OTHER SOURCES INCOME

The following expenses cannot be claimed as a deduction against income from other sources:

- Expenses incurred for earning casual income like lottery, horse races, and online gaming.
- Interest expense on dividend income can be claimed only up to 20% of the dividend received; any excess is not allowed.
- Personal expenses of the taxpayer.
- Interest paid outside India, wherein TDS not deducted on such payment.
- Expenses payable within India, on which TDS is not deducted (30% is disallowed)

4.7 ILLUSTRATION

Calculate income from other source from information given below:

i) Winning from lottery

ii) Amount received from race winnings

Gifts received during the previous year 2020-21

i) Received Rs 20000 gift from his friend

ii) Received Rs 100000 as gift from his elder brother

iii) Received Rs 140000 as gift on his marriage

iv) Received 80000 as gift from his NRI friend on 1.1.2006

v) Another gift of Rs 18000 received from his cousin

SOLUTION

Computation of income from other source

Income	Rs	Rs
i) Winning from lottery		100000
ii) Amount received from race winning		50000
to be grossed up [35000 x 100/70]		
Gifts Received		
i) Received Rs 20000gift from his friend	20000	
ii) Received Rs 100000 as gift from his elder brother	Nil	
(Gifts from relatives are exempted)		
iii) Received Rs 140000 as gift on his marriage	Nil	
(Gifts from marriage are exempted)		
iv) Received 80000 as gift from his NRI friend on 1.1.206	80000	
v) Another gift of Rs 18000 received from his cousin	18000	1, 18,000
Income from other sources		**2, 68,000**

CHECK YOUR PROGRESS

True or False

1. Winnings from horse races are taxed at normal slab rates.
2. Gifts received on marriage are exempt from tax under Income from Other Sources.
3. Personal expenses incurred for earning interest income are allowed as deduction.
4. Remuneration received by a director (not as an employee) is taxable under "Income from Other Sources".
5. Interest paid to a foreign entity without TDS is allowed as a deduction.

Answers;-

1. False (They are taxed at a flat rate of 30%)
2. True
3. False
4. True
5. False

4.8LET US SUM UP

Under the Income Tax act, income of every kind which is not to be excluded from the total income shall be chargeable to income tax under the head 'Income from other sources', if it is not chargeable to income tax under any of the other heads of income. Thus, income from other sources is a residuary head of income i.e.

income not chargeable under any other head is chargeable to tax under this head. All income other than income from salary, house property, business and profession or capital gains is covered under 'Income from other sources'. Two types of income are included in this head, General Incomes covered under section 56(1), and Specific Incomes covered under section 56(2).

4.9KEYWORD

Section 56(2) specifically provides for the certain items of incomes as being chargeable to tax under the head such as Dividend, Keyman Insurance policy, Winnings from lotteries, Contribution to Provident fund, Income by way of interest on securities, Income from hiring machinery etc,Hiring out of building with machinery, Money Gifts, Share premiums in excess of the fair market value to be treated as income, income by way of interest received on compensation.

The entire income of winnings, without any expenditure or allowance or deductions under Sections 80C to 80U, will be taxable. However, expenses relating to the activity of owning and maintaining race horses are allowable. Further, such income is taxable at a special rate of income-tax i.e., 30% + surcharge + cess @ 3%.

Income chargeable under Income-tax Act, which does not specifically fall for assessment under any of the heads discussed earlier, must be charged to tax as **"income from other sources".**

Admissible Deductions: The income chargeable under the head "Income from other sources" is the income after making the deductions such as

- sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such interest;
- deduction shall be allowable in accordance with the provisions of Section 36(1)(va), i.e., if the employer has credited the employee's accounts in the respective funds;
- a sum equal to 33-1/3% of the income or ` 15,000, whichever is less, is allowable as a deduction from family pension;
- a deduction of a sum equal to 50% of from Interest on compensation or enhanced compensation, and
- any other expenditure (not being in the nature of capital expenditure) laid out or expended whollyand exclusively for the purpose of making or earning such income.

Inadmissible deductions: The following amounts shall not be deducted in computing income chargeable under the head 'Income from other sources':

- Any personal expenses of the assessee.
- Any interest chargeable under the Income-tax Act which is payable outside India and from which income-tax has not been paid or deducted at source.
- Any payment which is chargeable under the head "Salaries" if it is payable outside India

unless tax has been paid thereon or deducted therefrom at source.

- Any expenditure referred to in Section 40A of Income-tax Act.
- The basis of charge on income by way of interest on securities is on "receipt" basis if books of account are maintained on cash basis. If the assessee does not maintain books of account or, when he maintains books of account on the basis of "mercantile system", it is taxable on "due" basis.

4.10 SELF ASSESSMENT QUESTIONS

1. What deductions are allowed under the head "Income from other sources"?

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2. Explain Specific Income. What are the items to be included under general and Specific Income?

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3. Explain the concept of admissible and inadmissible deductions.

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4.11 LESSON END EXERCISE

1. What are the incomes chargeable under the head "Income from other sources"?

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2. What deductions are not allowed under the head "Income from other sources"?

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3. Explain the deduction given in respect of certain incomes.

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4.12 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; Pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

INTEREST OF SECURITIES

STRUCTURE

5.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand the meaning and tax treatment of interest on securities.
- Identify securities exempted under Section 10(15).
- Distinguish between different types of securities.
- Explain bond washing transactions and their implications.

Learning outcomes

- Recognize taxable and exempt interest income from securities.
- Calculate income from interest on securities.
- Apply provisions of Section 94(1) and 94(2) to bond washing.
- Understand TDS applicability under Section 193

5.1 INTRODUCTION

In the modern financial and economic environment, individuals and institutions invest in various types of securities to earn a stable and secure return. One of the most common forms of return on such investments is interest, especially when the security is in the form of debentures, bonds, or government-issued instruments. The Indian Income Tax Act has specific provisions for taxing such income under different heads, primarily "Income from Other Sources" unless it qualifies to be taxed under "Profits and Gains from Business or Profession".

Interest on securities includes income earned from government securities, debentures, and bonds issued by companies, local authorities, and statutory corporations. Since this type of income can be predictable and passive in nature, it is often subject to Tax Deducted at Source (TDS) and specific rules regarding accrual, ownership, and exemptions. It is important to note that taxation on interest may vary depending on the type of security, whether it is a government or commercial instrument, and whether it is tax-free or taxable.

In certain cases, the entire interest income may be exempt from tax under Section 10(15) of the Income Tax Act, especially when the securities are issued for public welfare, infrastructure development, or held by certain exempt entities like political parties or charitable trusts.

Moreover, some taxpayers may attempt to reduce their tax liability through bond washing transactions, which involve selling securities before interest payment dates to relatives in lower tax brackets. The Income Tax Act addresses such avoidance techniques through anti-avoidance provisions under Section 94.

5.2 INTEREST ON SECURITIES

The income from interest on securities shall be chargeable to tax under income from other sources, if it is not taxable under the head income from business or profession. The following amounts due to an assessee in the previous year shall be chargeable to income tax as interest on securities.

1. Interest on any security of the central or state govts.
2. Interest on debentures or other securities issued by a local authority.
3. Interest on debentures issued by a company (whether Indian or foreign)
4. Interest on debentures or other securities issued by statutory corporation.

(i)- Interest on securities due to an assessee provided by the Central or the State Govt. shall be chargeable to tax under interest on securities.

(ii)- Interest on debentures or other securities for money issued or on the behalf of a local authority or a company or a corporation established by the Central, State of Provincial Act shall be charged to tax under interest on securities.

(iii)- Tax treatment of Interest:

- Any interest which accrues to a person during the previous year is added to his gross total income.

- Interest is taxable on due basis whether received or not.
- Interest on securities issued by the Govt. of India is considered to be accrued in India even if enforced to pay outside India.
- Interest accrues on the name of the person on whose name securities stand on the date of accrual of interest.

Deduction of Tax at source. It is the duty of the security issuing authority to deduct tax at source before making the payment of interest on securities at the prescribed rate. (Section 193)

1. No TDS in case of Interest on Debentures (section 193), if certain conditions are fulfilled, these are:

(i) Debentures are issued by a company in which the public are substantially interested.

(ii) Interest is paid to a resident debenture holder.

(iii) Debentures are listed on a recognized stock exchange.
(iv) Interest is paid through account payee cheque.

(v) The amount of interest does not exceed Rs. 5000, payable in a financial year.

2. Commission on Sale of Securities:

(i) Any amount of commission or other form incurred by the assessee in case of purchase or sale of securities is not allowable deduction out of the income of interest on such securities.

(ii) Any amount of commission paid at the time of purchase of securities are included in the cost of these securities and any commission paid on the sale of such securities are allowed to be deducted out of the selling price of these securities.

5.3 INTEREST ON SECURITIES EXEMPTED FROM TAX U/S 10 (15)

Interst on Securities exempted from Tax. U/S 10(15)

A. Interest on certain type of Bonds issued by public sector companies/undertakings has been exempted from tax, these are:

1. 7% capital investment bonds.

2. 10% secured redeemable NTPC bonds 1986. (Ist series)

3. 9% and 10% secured redeemable non-convertible bonds issued by Indian Railway Finance

Corporation.

4. 10% secured redeemable non-convertible bonds issued by Mahanagar Telephone Nigam Ltd.

5. 10% secured redeemable non-convertible bonds 1987 (B series) issued by National Hydro Electric Power Corporation Ltd.

6. 9% (Tax free) secured redeemable bonds issued by Power Finance Corporation Ltd.

7. 6.5%, 8%, 9%, and 10% National Relief Bonds.

8. 10% (Tax free) secured redeemable non-convertible bonds issued by Indian Telephone Industries Ltd.

9. 10-years 9% (Tax free) secured redeemable non-convertible PFC bonds- II series (private placement) issued by issued by Power Finance Corporation.

10. 10-years 9% (Tax free) secured redeemable non-convertible NTPC bonds-IV issue (private placement).

11. 10-years 9% (Tax free) secured redeemable non-convertible REC bonds issued by the Rural Electrification Corporation Ltd.

12. 10-years 9% (Tax free) secured redeemable non-convertible (C series) issue by Neyveli Lignite Corporation Ltd.

B. Interest on Securities exempted from Tax.

- Interests on securities earned by the following types of assessees are exempted from tax.

1) Political parties.

2) A local authority.

3) A registered trade union.

4) Trustees of a recognized provident fund.

5) An approved scientific research association.

6) Members of scheduled tribes living in tribal areas.

7) A non-resident of Indian origin and securities and bonds were issued before June 1, 2002.

8) Public charitable and religion trusts.

CHECK YOUR PROGRESS

True or False

1. Interest on securities is always taxed under the head "Profits and Gains from Business or Profession".

   ➢**False**

   It is usually taxed under "Income from Other Sources" unless it's part of business income.
2. TDS is never deducted on interest from government securities.

   ➢**True**

   Government securities are generally exempt from TDS under Section 193.
3. Bond washing transactions are allowed and encouraged to save tax.

   ➢**False**

   They are considered tax avoidance and are discouraged under Section 94.

5.4 KINDS OF SECURITIES

There are four types of securities.

1. Tax free government securities: The interest on these securities is fully exempt from tax. The interest on such securities is neither included in total income nor taxed.

2. Less tax government securities: These securities are issued by central govt or state government. These securities are taxable securities. But no tax is deducted at source on such securities. Therefore the interest on such securities will not be grossed up.

3. Tax free commercial securities: These securities are issued by local authority or Statuary Corporation or a company in the form of debentures or bonds. Actually the interest is not tax free. Income tax due on this interest is payable by the company or authority or Statuary Corporation. These are called tax free because the assessee is not required to pay tax on it. The interest due to an assessee is grossed up and this grossed up amount is included in the total income.

4. Less tax commercial securities: These are taxable securities. In this case income tax is deducted at source on the amount of interest calculated at the percentage stated on the securities. In this type of securities, if the net amount of interest is given, it has got to be grossed up. If the rate of percentage of interest is given it is not grossed up.

5.5 BOND WASHING TRANSACTION

A bond-washing transaction is a transaction where securities are sold sometime before the due date of interest and reacquired after the due date is over. This practice is adopted by persons in the higher income group to avoid tax by transferring the securities to their relatives/friends in the lower income group just before the due date of payment of interest. In such a case, interest would be taxable in the hands of the transferee, who is the legal owner of securities. In order to discourage such practice, section 94(1) provides that where the owner of a security transfers the security just before the due date of interest and buys back the same immediately after the due date and interest is received by the transferee, such interest income will be deemed to be the income of the transferor and would be taxable in his hands. In order to prevent the practice of sale of securities-cum-interest, section 94(2) provides that if an assessee who has beneficial interest in securities sells such securities in such a manner that either no income is received or income received is less than the sum he would have received if such interest had accrued from day to day, then income from such securities for the whole year would be deemed to be the income of the assessee.

CHECK YOUR PROGRESS

One-Word Answer

1. Which section of the Income Tax Act deals with exemptions on interest income from specified bonds?

   ➢10(15)

2. What is the term used for calculating gross income from net interest after TDS?

   ➢Grossing Up

3. Name the head of income under which interest on securities is generally taxable.

   ➢Other Sources

5.6 ILLUSTRATION

Mr. R held the followingInvestments:

a) Rs 9000 10% (tax-free) Debentures of a listed company (rate of TDS 10%)

b) Rs 100000 12% Punjab govt. loan.

Compute his income from interest on securities for the year ending 31-3-2021

SOLUTION

Computation of Income from interest on securities

	Rs
b) Rs 90,000 10% (tax free) Debentures (listed) [9000 x 100/90]	10,000
c) Rs 100000 12% Punjab Govt. Loan	12,000
Income from Interest on securities	22,000

5.7LET US SUM UP

The income from interest on securities shall be chargeable to tax under income from other sources, if it is not taxable under the head income from business or profession. The following amounts due to an assessee in the previous year shall be chargeable to income tax as interest on securities.Interest on any security of the central or state govts, Interest on debentures or other securities issued by a local authority, Interest on debentures issued by a company (whether Indian or foreign), Interest on debentures or other securities issued by statutory.

CHECK YOUR PROGRESS

Fill in the Blanks

1. Interest on securities is taxable under the head _______________, unless it is part of business income.
2. _______________ is the process of adjusting net interest received to its gross amount before tax.
3. Interest is taxable on _______________ basis, whether received or not.
4. Under Section _______________ of the Income Tax Act, certain interest incomes are fully exempt.
5. In a bond washing transaction, securities are transferred just before the _______________ of interest.
6. _______________ is the section of the Income Tax Act that deals with TDS on interest from securities.
7. No TDS is deducted if interest on listed debentures is paid via _______________ cheque and does not exceed ₹5000.
8. _______________ and _______________ are examples of public sector companies whose bonds may be exempt from tax.

Answers

1. **Income from Other Sources**
2. **Grossing up**
3. **Due**
4. **10(15)**
5. **Due date**
6. **193**
7. **Account payee**
8. **NTPC**, **PFC**

5.8 KEYWORDS

Interest on Securities

Income earned by an individual or entity from investments in instruments like government bonds, company debentures, or securities issued by local authorities or statutory corporations. This interest is generally taxable under the head "Income from Other Sources" unless it falls under Business or Profession.

Tax Deducted at Source (TDS)

A tax collection mechanism where the issuer of the security deducts a certain percentage of tax from the interest payment before crediting it to the investor. TDS on interest from securities is governed by Section 193 of the Income Tax Act.

Section 10(15)

A provision under the Indian Income Tax Act that exempts certain interest incomes from tax. This includes interest on specified government bonds and securities, and applies to eligible persons or entities like public trusts, NRIs (in some cases), and charitable institutions.

Tax-Free Securities

Securities where the interest income is not taxable in the hands of the holder. Either the issuer pays the tax on behalf of the investor, or the income is fully exempt under specific provisions like Section 10(15).

Bond Washing Transaction

A tax avoidance scheme where a high-income individual transfers securities just before the interest due date to someone in a lower tax bracket, and repurchases them afterward. The Income Tax Act counters this with Section 94(1), taxing the original owner.

Grossing Up

A method used to calculate the gross (pre-tax) income from the net (post-TDS) interest received. It helps in determining the correct taxable income when TDS has already been applied.

5.9 SELF ASSESSMENT QUESTIONS

1. What is meant by "Interest on Securities"? Under which head of income is it taxable?

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2. State any three conditions under which no TDS is deducted on interest from debentures.

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3. What is the tax treatment of interest on tax-free commercial securities?

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5.10 LESSON END EXERCISE

1. Explain the provisions of Section 10(15) regarding exemption of interest income from securities. Provide examples of exempted bonds.

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2. Differentiate between the four types of securities based on tax treatment.

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3. What is a Bond Washing Transaction? How is it prevented under the Income Tax Act?

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5.11 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

8.

SET OFF OF LOSSES

STRUCTURE

6.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand what types of losses can occur under different heads of income (business, capital, house property).
- Learn how losses can be adjusted within the same head (intra-head) and across different heads (inter-head).
- Know the restrictions and special rules for setting off losses for individuals, HUFs, and firms.
- Understand which losses can be carried forward to future years and under what conditions.

Learning outcomes

- Explain how and when losses can be set off against various types of income.
- Apply the rules of set-off to calculate taxable income.
- Identify losses that cannot be set off and understand the limits on set-off.
- Demonstrate knowledge of carrying forward losses and using them in subsequent years to reduce tax liability.

6.1 INTRODUCTION

Profit and losses are two sides of a coin. Losses, of course, can be painful but not as much as you think it is. The Income Tax Act provides provisions for set-off and carry-forward of losses. Each loss arising can be setoff against income within the head or other heads. Further, the excess loss can be carried forward to the next assessment years for a specific time period and setoff against the income of that year.

Income tax is levied on the total income of previous year of an assessee. Hence it is necessary to ascertain the total income by aggregating the income of different heads. An assessee may have both positive income and negative income (loss). The department of income tax have given relief to assessees that if there is loss from one head of income it can be set off from other heads of income. But if a loss cannot be set off in the same assessment year it can be forward and set off in future against income of that year.

6.2 MEANING OF SET OFF OF LOSSES

- Set-off of losses means adjusting the losses against the profit or income of that particular year.
- Losses that are not set off against income in the same year can be carried forward to the subsequent years for set off against income of those years.

Simply speaking, it means utilizing losses to reduce taxable income and save taxes.

A loss can be set-off primarily within the same head and if it still remains unadjusted it can be set off from other heads of income.

6.3 INTRA HEAD SET OFF

Set-off of loss from one source against income from another source within the same head of income. [Section 70].

The general rule is that loss from one source can be set-off from another source falling under the same head of income. For example, an assessee is running two businesses A and B. There is a profit of Rs 200,000 in business A whereas there is a loss of Rs. 100,000 in business B. The assessee can setoff loss from business B with the income of business A and his total income will be Rs 100,000. However there are six exceptions to the rule that a loss can be set-off against any other income under the same head.

1. Loss from speculation business cannot be set off against income from other sources. This loss can be set off only against income from another speculation business.

2. Loss of specified business under section 35AD cannot be set off against income from other business. This loss can be set off only against income from other specified business.

3. Long term capital loss cannot be set off against short term capital gain. This loss can be set off only against

long term capital gain.

4. Loss from the activity of owning and maintaining race horses shall be set off against income from owning and maintaining race horses only and not against any other income under the head other sources.

5. Loss in respect of casual income falling under section 56(2)(ib), viz, lottery, gambling, betting, winning from races (including horse races) cannot be set-off against any income falling under head other sources. In fact, such a loss can't be set off at all.

6. Loss from an exempted source can't be set-off from a source of income which is taxable. For example, agriculture income can't be set-off from non-agriculture income.

CHECK YOUR PROGRESS

Fill-in-the-Blanks:

1. A loss under the head 'Profits and Gains of Business or Profession' can be set off only against _________ income.
   - Answer: business
2. A loss from the activity of owning and maintaining race horses can only be set off against _________ income.
   - Answer: race horse winnings
3. Speculation losses can only be set off against _________ income.
   - Answer: speculation
4. A long-term capital loss can only be set off against _________ capital gains.
   - Answer: long-term

6.4 INTER HEAD SET OFF

Set-off of loss of one head against the income of another head in the same assessment year, i.e., inter-head set-off [Section 71]:

The general rule is that loss under one head of income can be adjusted against income under another head. However, there are certain exceptions to this rule as:

1.Where the net result of the computation under any head of income (other than 'Capital Gains') is a loss, the assessee can set-off such loss against his income assessable for that assessment year under any other head, including 'Capital Gains'.

2,Where the net result of the computation under the head "Profits and gains of business or profession" is a loss, such loss cannot be set off against income under the head "Salaries".

3. Where the net result of computation under the head 'Capital Gains' is a loss, such capital loss cannot be set-off against income under any other head.

4. Speculation loss and loss from the activity of owning and maintaining race horses cannot be set off against income under any other head.

Type of Loss	Can Be Set Off Against	Cannot Be Set Off Against
Speculative Business Loss	Profit from speculative business	Income from other business or profession or any other income
Loss from Owning & Maintaining Racehorses	Profit from the same activity (racehorses).	Any other income
Long-term Capital Loss	Long-Term Capital Gains only	Short-Term Capital Gains or any other income
Short-term Capital Loss	Both short-term and long-term capital gains	Any other income
Loss from Specified Business	Profit from other specified businesses	Any non-specified business or profession or any other income
Loss from Other Business or Profession	Profits from both specified and non-specified businesses	Salary Income
Loss from House Property	Set off allowed.	For Old regime: Any other head up to Rs.2 lakhs. For New Regime: Cannot be set off against any other income

NOTE:- It is important to understand that any losses should first be set-off against the income from the same head. Such loss can only be set-off against incomes from other heads only when there is no income in the relevant head or the loss is more than the income under that head.

CHECK YOUR PROGRESS

True/False Questions:

1. **Loss under the head 'Capital Gains' can be set off against income under any other head, including 'Salary'.**
   - **False**.
     Capital losses can only be set off against capital gains, not against other heads like salary.
2. **A business loss can be set off against income under the head 'Salary'.**
   - **False**.
     Business losses cannot be set off against salary income; they can only be set off against business profits.
3. **A speculation loss can be set off against income from house property.**
   - **False**.

Speculation losses can only be set off against speculation income, not against income from house property.

4. **Long-term capital loss can be set off only against long-term capital gains.**
   - **True**.

     Long-term capital losses can only be set off against long-term capital gains.

6.5 ILLUSTRATION

ILLUSTRATION II

Mr. M Rafiq submits the following information of his incomes and losses for the year ending 31-3-2021.Compute his total income:

	Rs
1. Salary income (computed)	24,000
2. Income from house property :	
House A (income)	10,000
House B (loss)	40,000
House C (self-occupied)	28,000
3. Income from business:	
Cloth business (profit)	10,000
Hardware business (loss)	12,000
Speculation (profit)	12,000
Speculation (loss)	17,000

4. Capital gains:	
Short-term (gain)	8,000
Short-term (loss)	24,000
Long-term (gain)	8,000
5. Other Sources:.	
Income from betting	12,000
Income from card games	9,000
Interest from securities (gross)	8,000

SOLUTION

Computation of total income of Mr.Rafiq

	Rupees	**Rupees**	**Rupees**
Salaries			
Salary income (computed)			**24,000**
House property			
House A		+10,000	
House B		-40,000	
House C		-28,000	
House property loss to be set off from other heads			**-58,000**
Profits &Gains:			

	Rupees	**Rupees**	**Rupees**
Cloth business	+10,000		
Set off Hardware business loss	-12,000	-2,000	
Speculation (profit)	+12,000		
Set off speculation loss	-17,000		
Speculation loss to be C/F	- 5,000	Nil	
Business loss to be set off from other heads			**-2,000**
Capital Gains:			
STCG	+8,000		
Set off STCL	-24,000		
	-16,000		

LTCG	+8,000		
STCL to be C/F	-8,000Nil		
Other sources:			
Income from betting	12,000		
Income from cards	9,000	21,000	
Interest on securities		8,000**29,000**	
Total income (Casual income)			**21,000**

Note:

1. Business loss shall be set off from income from interest on securities.
2. House property loss of 58,000 shall be set off from salary income of 24,000 and balance from interest on securities 6,000.Unadjusted house property loss 28,000 shall be C/F.
3. No loss can be set off from casual incomes.

6.6 LET US SUM UP

The set-off of losses under the Income Tax Act is a mechanism that allows taxpayers to reduce their overall taxable income by offsetting losses from one source against profits from another. However, there are several important exceptions to ensure that losses are only set off in a manner consistent with the nature of the income.

- Losses under heads like "Salary" can be adjusted against other income heads, except in cases like business losses, which cannot be set off against salary income.
- Capital losses have specific provisions: short-term losses can be adjusted against both short-term and long-term capital gains, while long-term capital losses can only be adjusted against long-term capital gains.
- Certain losses, such as speculation losses and losses from owning race horses, are restricted to set-off only against income derived from the same source, thus ensuring that they cannot be used to offset income from other heads.
- Unused losses can often be carried forward to future years, allowing taxpayers to offset them against future income in specific heads, further aiding tax efficiency.

Ultimately, while the set-off mechanism provides flexibility to reduce taxable income, the specific rules and exceptions aim to maintain a clear distinction between different types of income and losses. Taxpayers should carefully consider these provisions when filing their returns to ensure they are in compliance with the law and making the most of available tax reliefs.

CHECK YOUR PROGRESS

Multiple Choice Questions (MCQs):

1. **Which of the following losses can be set off against income from other heads?**
   - a) Speculation Loss
   - b) Capital Loss
   - c) Business Loss
   - d) Salary Loss
   - **Answer: c) Business Loss**

     (Business loss can be set off against business income or carried forward.)
2. **A long-term capital loss can be set off against:**
   - a) Short-term capital gains
   - b) Both short-term and long-term capital gains
   - c) Only long-term capital gains
   - d) Income under any head
   - **Answer: c) Only long-term capital gains**

     (Long-term capital loss can only be set off against long-term capital gains.)
3. **Speculation loss can be adjusted against which type of income?**
   - a) Salary
   - b) Speculation income
   - c) House property income
   - d) None of the above
   - **Answer: b) Speculation income**

     (Speculation losses can only be adjusted against speculation income.)
4. **In case of a loss under the head 'Capital Gains', what happens?**
   - a) The loss can be set off against any other head of income
   - b) The loss can be carried forward to future years
   - c) The loss is ignored and does not affect tax calculations
   - d) The loss is added to the business loss
   - **Answer: b) The loss can be carried forward to future years**

     (Capital losses can be carried forward to future years for set-off against future capital gains.)
5. **A loss from owning and maintaining race horses can be set off against:**
   - a) Income from salary
   - b) Income from business
   - c) Income from race horse winnings
   - d) Any other source of income

- **Answer: c) Income from race horse winnings**

  (Losses from race horses can only be set off against income from similar activities.)

6.7 KEYWORDS

Set-Off Losses: When any loss relating to any particular previous year is set-off against the income of same previous year, it is called set-off of losses.

Carry forward of loss: If any loss related to any previous year(or assessment year) cannot be sett- off either under the same head or against the incomes of other heads during same previous year(or assessment year), such a loss can be carried forward to future previous years for setting off against incomes of future previous years(or assessment years).

Speculation Loss: Any loss computed in respect of speculation business. Such a loss carried by an assessee shall not be set-off except against profits and gains,if any, of another speculation business**.**

Business Loss:

A loss incurred from the normal business operations. It cannot be set off against salary income but can be carried forward to offset future business profits.

Unabsorbed Loss:

A loss that remains after attempting to set it off against other sources of income within the same assessment year. These losses can often be carried forward to future years.

6. 8 SELF ASSESSMENT QUESTIONS

1. What do you mean by “Set-off?

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2. Discuss the provisions of the Income-tax Act relating to the set-off of losses.

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3. Discuss the conditions and restrictions applicable for set off of losses from business income against income from other sources.

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6.9 LESSON END EXERCISE

1. Explain the rules for intra-head set off of losses with suitable examples.

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2. Explain the rules for inter-head set off of losses with suitable examples.

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3. What is the difference between set off and carry forward of losses under the Income Tax Act?

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6.10 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

UNIT – II **B.COM 4th SEMESTER**

COURSE No. BCG-402 **LESSON No. 7**

CARRY FORWARD OF LOSSES

STRUCTURE

7.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand what types of losses can be carried forward under the Income Tax Act.
- Learn the conditions required for carrying forward losses, including timely filing of tax returns.
- Know the time limits and restrictions on carrying forward different kinds of losses.
- Understand how carry-forward losses can be set off in subsequent assessment years.

Learning outcomes

- Identify which losses are eligible for carry forward and for how many years.
- Explain the rules and conditions necessary to carry forward losses legally.
- Apply the carry forward and set-off provisions to compute taxable income for future years.

7.1 INTRODUCTION

Under the Income Tax Act of India, the concept of carrying forward of losses is a crucial provision that allows taxpayers, including individuals, firms, and companies, to offset losses incurred in a particular financial year against taxable income in future years. This mechanism is designed to provide relief to taxpayers, especially businesses, that face periods of low or negative profits, thereby allowing them to reduce their tax burden in subsequent years when they earn profits.

In India, the Income Tax Act, 1961, includes specific provisions for the carry forward and set off of different types of losses, such as business losses, capital losses, and losses from house property. The idea behind these provisions is to smooth out the fluctuations in income over time, allowing businesses to offset losses during lean years with profits in future years. This helps stabilize their financial position and makes it easier to plan for long-term growth.

The carry forward of losses is not an automatic right but is subject to certain conditions and time limits as prescribed under the Income Tax Act. The taxpayer must have filed their income tax returns within the due date for claiming the carry forward of losses, otherwise, they may lose the benefit of carrying forward those losses.

7.2 MEANING OF CARRY FORWARD OF LOSSES

If it is not possible to set off the losses in the same assessment year in which they were incurred, the unadjusted portion of the loss can be carried forward to subsequent years for being set off against future income, provided the losses were determined in a return filed by the assessee within the time prescribed under Section 139(1), and the same assessee who incurred the loss claims the carry forward. After making the appropriate intra-head and inter-head adjustments, any remaining unadjusted losses can be carried forward to be set off against income in future years. However, it is important to note that the rules regarding the carry forward of losses vary slightly depending on the specific head of income, with each category of loss—such as business losses, capital losses, or losses from house property—having different conditions and time limits for carry forward.

7.3 CARRY FORWARD OF VARIOUS TYPES OF LOSSES

Carry Forward of Various Types of Losses under the Indian Income Tax Act:

7.3.1 **Losses from House Property (Section 71 B)**

- Can be carry forward up to next 8 assessment years from the assessment year in which the loss was incurred

- Can be adjusted only against Income from house property
- Can be carried forward even if the return of income for the loss year is filed under belated return.
- If individuals, HUF, AOP, BOI, opting to pay taxes under old tax regime, loss under the head income from house property firstly set off against income from any other head to the extent of Rs 2,00,000 during the same year, unobserved loss will be carried forward to the following assessment year to be set off against income under the head income from house property of future years.
- Under the new tax regime, loss under the head income from house property would not be allowed to be set off against income under any other head.

Let's try to understand this with below example

Mr Rama aged 45 years submits the following income pertaining to the FY 2024-25

- Income from salary Rs 4,20,000
- Loss from let out property Rs -2,30,000
- Business Loss Rs -1,20,000
- Bank Interest received Rs 85,000

Computation of income under old tax regime

Particulars	Amount	Amount
Income From Salary	4,20,000	
Less: Loss from House Property of Rs. 2,30,000 but restricted to Rs. 2,00,000	-2,00,000	2,20,000
Income From Other Sources		
Interest Income	85,000	
Less: Business loss Rs. 1,20,000 but restricted to Rs. 85,000	-85,000	-
Gross Total Income		2,20,000

Note:- (a) The balance loss of Rs 30,000 from house property to be carried forward to next assessment year for set-off against income from house property of that year.

(b) Remaining business loss of Rs 35,000 will be carried forward as it cannot be set off against salary income and allowed for set-off against income from house property of that year.

Computation of income under New tax regime

Particulars	**Amount**	**Amount**
Income From Salary		4,20,000
Income From Other Sources		

Interest Income	85,000	
Less: Business loss Rs. 1,20,000 but restricted to Rs. 85,000	-85,000	-
Gross Total Income		4,20,000

Note : (a) loss from house property cannot be set off against income under any other head. Therefore, the entire loss of Rs 2,30,000 from house property to be carried forward to next assessment year for set-off against income from house property of that year.

(b) Remaining business loss of Rs 35,000 will be carried forward as it cannot be set off against salary income.

7.3.2 **Losses from Non-Speculative Business (Regular Business) Loss (Section 72)**

- The Loss should have been incurred in business
- Can be carried forward up to next 8 assessment years from the assessment year in which the loss was incurred
- Can be adjusted only against Income from business or profession
- Not necessary to continue the business at the time of set off in future years
- Cannot be carried forward if the return is not filed within the original due date.
- Person who incurred the loss alone is entitled to carry forward & set-off the loss (it can not transferred to any other person)

CHECK THE PROGRESS

One-Word Answer:

1. What is the maximum period for carrying forward business losses?
   (Answer: 8 years)
2. Which section of the Income Tax Act deals with unabsorbed depreciation?
   (Answer: Section 32)
3. What term is used to describe losses that cannot be set off in the current year and are carried forward to future years?
   (Answer: Unabsorbed depreciation)
4. Which type of loss has priority in being set off in future years: business loss or unabsorbed depreciation?
   (Answer: Unabsorbed depreciation)
5. Under the Income Tax Act, what is the maximum period for carrying forward speculative business losses?
   (Answer: 4 years)

7.3.3 **Speculative Business Loss (Section 73)**

- Can be carry forward up to next 4 assessment years from the assessment year in which the loss was incurred
- Can be adjusted only against Income from speculative business
- Cannot be carried forward if the return is not filed within the original due date.
- Not necessary to continue the business at the time of set off in future years

7.3.4 **Specified Business Loss under 35AD (Section 73 A)**

- No time limit to carry forward the losses from the specified business under 35AD
- Not necessary to continue the business at the time of set off in future years
- Cannot be carried forward if the return is not filed within the original due date
- Can be adjusted only against Income from specified business under 35AD
- Not necessary to continue the business at the time of set off in future years

7.3.5 **Capital Losses (Section 74)**

- Can be carry forward up to next 8 assessment years from the assessment year in which the loss was incurred
- Long-term capital losses can be adjusted only against long-term capital gains.
- Short-term capital losses can be set off against long-term capital gains as well as short-term capital gains
- Cannot be carried forward if the return is not filed within the original due date

Let us understand with an example-

Mr P has invested in equity shares. Below are the details related to his capital gain/loss transactions for different years.

A.Y.	**STCL during the year**	**LTCL during the year**	**STCG during the year**	**LTCG during the year**	**STCG taxable**	**LTCG taxable**	**Balance STCL and LTCL to be c/f**
2020-21	3,000	1,000	-	-	-	-	STCL- 3,000 LTCL- 1,000
2021-	-	1,300	5,600	-	2,600	-	STCL-

22					(5,600-3,000) Set-off against LTCL		Nil LTCL-2,300
2022-23	800	-	-	7,000	-	3,900 (7,000-2,300-800) Set-off against STCL and LTCL	STCL-Nil LTCL-Nil
2023-24	1,200	4,000	3,000	9,000	3,000*	3,800* (9,000-4,000-1,200) Set-off against STCL and LTCL	STCL-Nil LTCL-Nil

*** The order of adjusting STCL and LTCL is not prescribed in the Act. Hence, the STCL and LTCL are first adjusted with LTCG of the year to reduce the tax liability.**

7.3.6 **Losses from Owning and Maintaining Race-Horses (Section 74 A)**

- Can be carry forward up to next 4 assessment years from the assessment year in which the loss was incurred
- Cannot be carried forward if the return is not filed within the original due date
- Can only be set off against income from owning and maintaining race-horses only

Note:

1. A taxpayer incurring a loss from a source, income from which is otherwise exempt from tax, cannot set off these losses against profit from any taxable source of Income
2. Losses cannot be set off against casual income i.e. crossword puzzles, winning from lotteries, races, card games, betting etc.

CHECK THE PROGRESS

True or False:

1. Unabsorbed depreciation can be carried forward indefinitely until fully set off against future profits.

   Answer: True

   (Unabsorbed depreciation can be carried forward indefinitely with no time limit under the Income Tax Act.)
2. Unabsorbed depreciation has a time limit of 8 years for carry forward under the Income Tax Act.

   Answer: False

   (Unabsorbed depreciation can be carried forward indefinitely with no time limit.)
3. Business losses can be set off against unabsorbed depreciation in the order of current depreciation, business loss, and unabsorbed depreciation.

   Answer: False

   (The correct order is: current depreciation → brought forward business loss → unabsorbed depreciation.)
4. Unabsorbed depreciation is treated as depreciation of the succeeding year and can be set off against any type of income.

   Answer: False

   (Unabsorbed depreciation is treated as depreciation of the succeeding years but can only be set off against business income.)
5. Losses from speculative business can be carried forward for a maximum period of 8 years.

   Answer: False (Speculative losses can be carried forward for a maximum of 4 years.)

7.3.7 **Rules regarding unabsorbed depreciation (Section 32(2))**

- With effect from AY 2003-04, unadjusted depreciation can be carried forward till it is fully adjusted from any income during the succeeding previous years. It shall be treated as depreciation of succeeding previous years. In case there is carry forward business loss as well as carry forward unabsorbed depreciation, then the following order should be followed for set off

- Firstly current depreciation secondly brought forward business loss and thirdly brought forward unabsorbed depreciation.

Section	Losses to be Carried Forward	Can be Set off against Income	Time up to which losses can be Carried Forward	Mandatory to file return in the year of loss before the due date?
32(2)	**Unabsorbed depreciation**	Any income (other than salary)	No time limit	No
71B	**Loss from House property**	Income from house property	8 years	No
72	**Loss from Normal business**	Income from business	8 years	Yes
73	**Loss from speculative business**	Income from speculative business	4 years	Yes
73A	**Loss from specified business**	Income from specified business	No time limit	Yes
74	**Short term capital loss (STCL)**	Short term capital gain (STCG) and long term capital gain (LTCG)	8 years	Yes
	Long term capital loss (LTCL)	LTCG	8 years	Yes
74A	**Loss from owning and maintaining horse races**	Income from owning and maintaining horse races	4 years	Yes

7.4 ILLUSTRATION

Mr. Singh a resident of India, submits the following particulars of his income for the assessment year 2021-22.

		Rupees
I.	Income from house let out(computed)	9,500

II.	Profit from radio business	19,600
III.	Profit from electric business	1,800
IV.	Speculation income	19,00
V.	Short-term capital gain	32,00
VI.	Long –term capital gain (jewelry)	9,250
	Current year's depreciation amounted to	2,500

The following items have been brought forward from preceding assessment year:

I.	Loss from cycle businesses discontinued(2019-20)	3,900
II.	Loss from electric business	2,700
III.	Loss from radio business	1,900
IV.	Unabsorbed depreciation of electric bussiness	1,000
V.	Unabsorbed family planning expenditure	2,600
VI.	Speculation loss	3,200
VII.	STCL from the year 2017-18	4,100
VIII.	LTCL from the year 2018-19	6,450

You are required to compute his gross total income and deal with the carry forward of losses.

SOLUTION:

Computation of total Income of Mr. Singh

House Property Rupees Rupees Rupees

Income from let out house (computed) 9,500 Business Income

i. Profit from radio business 19,600
ii. Share of profit from electric business 1,800
21,400
Less:Current year's depreciation 2,500
18,900
Set off B/F loss from cycle business 3,900
Rupees **Rupees Rupees**
Set off B/F loss from radio business 1,900
Set off B/F loss from electric business 2,7008500
10,400

Set off B/F unabsorbed depreciation 1,000 9,400

Speculation Business income 1,900

Set off B/F loss from speculation business -3,200

This loss shall be C/F to be set off against speculation income of future -1,300 Nil 9,400

Capital Gains			
STCG	3,200		
Set off STCL of 2012-13	4,100	-900	
LTCG	9,250		
Set off LTCL loss B/F	6,450+2800		
Taxable Capital gain			1,900
Total income			20,800

Note:

Loss from speculation business is not allowed to be set off out of the profits of a non – speculation business.

Unabsorbed expenditure on family planning is not allowed to be deducted in case of non- company assesses.

Loss of a discontinued business can set off out of profits of a continuing business.

ILLUSTRATION

The assessment of M & Bros. for the assessment years 2020-21 and 2021-22shows the following results:

	Ass. Year 2020-21	Ass.Year 2021-22
I Interest on securities	-2,000	+2,000
Ii Income from house property	+8,000	+8,000
PGBP:		
a. Dealing in fruits	-30,000	-12,000
b. Manufacturing glass:		
Profit before depreciation	+50,000	+1,40,000
Depreciation	+80,000	+75,000
c. Speculative transactions	+6,000	-9,000
Iv Income from other sources (bank interest)	+2,000	+5,000
V Short term capital gain	Nil	-25,000

Compute net assessable results for each of the two years giving full reasons for your working.

SOLUTION

Calculation of total income of M& Bros. for assessment year 2020-21

RupeesRupeesRupees

Income from house property+8,000

Profits &gains:

a. Dealing in fruits + 50,000 -30,000

b. Glass Manufacturing

Less: Current depreciation	-80,000		
Unabsorbed depreciation	-30,000	Nil	
c. Speculation profit		+6,000	
Net loss from business			-24,000
Income from other sources:			
a. Bank interest		+2,000	
RupeesRupeesRupees			
Interest on securities -2,000 Nil			
Gross total income			Nil

Note: Loses to be C/F

a. Unabsorbed Depreciation	30,000
b. Business loss to be C/F	16,000

(After adjusting 8,000 from HP income)

Calculation of total Income of M & bros. for assessment year 2021-22:

Income from house property		+18,000	
Profits & Gains:			
a. Dealing in fruits		-12,000	
b. Glass Manufacturing	+1,40,000		
Less: Current Depreciation	75,000		
Business profit		+65,000	
Balance business income		53,000	
B/F business loss		-16,000	
		37,000	
Unabsorbed depreciation		-30,000	+7,000
c. Speculation loss to be C/F		9,000	

Income from other sources:

a. Bank interest	+5,000
b. Interest on securities	+2,000

+7,000

Total income 22,000

Notes:

1. Capital loss of 25,000 to be C/F as it cannot be set off from any other income.
2. Speculation loss to be C/F 9,000.

7.5 LET US SUM UP

The carry forward of losses provision under the Indian Income Tax Act plays a vital role in providing tax relief to taxpayers who face temporary financial setbacks. It ensures that businesses and individuals do not lose out on tax benefits simply because they experienced losses in a particular year. By allowing losses to be carried forward and offset against future profits, the Act helps smoothen the fluctuations in income over time and provides businesses with the flexibility to manage their tax liabilities.

However, to fully benefit from these provisions, taxpayers must be aware of the specific rules and deadlines laid down by the Income Tax Act. Non-compliance with the requirement of filing returns on time or failing to understand the restrictions on different types of losses can result in the forfeiture of the ability to carry forward those losses. Additionally, the carry forward of losses must be done in a manner that aligns with the tax laws and business operations.

Thus, taxpayers, particularly businesses, must carefully plan their finances, keep track of their losses, and ensure timely compliance with tax regulations to make the most of the carry forward of losses provisions. This mechanism not only helps in reducing immediate tax liabilities but also ensures a more stable financial outlook for taxpayers over time.

CHECK THE PROGRESS

Match the Column:

Column A	**Column B**
1. Unabsorbed Depreciation	A. 8 years
2. Business Losses	B. Can be carried forward indefinitely
3. Speculative Losses	C. Current depreciation → Business loss → Unabsorbed depreciation
4. Set-off Priority	D. 4 years
5. Capital Losses	E. 8 years

ANSWER:-

1. B, 2. A, 3. D, 4. C, 5. E

7.6 KEYWORDS

Carry forward of loss: If any loss related to any previous year (or assessment year) cannot be set- off either under the same head or against the incomes of other heads during same previous year (or assessment year), such a loss can be carried forward to future previous years for setting off against incomes of future previous years (or assessment years).

Speculation Loss: Any loss computed in respect of speculation business. Such a loss carried by an assessee shall not be set-off except against profits and gains,if any, of another speculation business.

Business Loss (Section 72): A loss incurred from running a business or profession that can be carried forward for up to 8 years to offset future business profits.

Capital Loss (Section 74): A loss arising from the sale of a capital asset (like property, stocks, etc.). These losses can be carried forward for up to 8 years and offset against future capital gains.

Speculative Loss (Section 73): A loss arising from speculative transactions (e.g., stock trading), which can only be set off against speculative business income in future years. Speculative losses can be carried forward for 4 years.

Loss from House Property (Section 71B): Losses arising from rental income or interest paid on a property that exceeds the rental income. These losses can be carried forward for 8 years and offset against future rental income.

Unabsorbed Loss: A loss that has not been fully utilized in the same year and is therefore carried forward to future years to be set off against future income.

Losses Incurred in Business/Profession: Losses resulting from business operations or professional activities that can be carried forward to offset business income in subsequent years.

Losses from Speculative Business: Losses that arise specifically from speculative activities like trading in stocks or commodities. These losses can only be set off against other speculative income.

7.7 SELF ASSESSMENT QUESTIONS

1. What do you mean by “Carry forward of losses”?

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2. Which types of losses can be carried forward and for how many years according to the Income Tax Act?

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3. Can losses be carried forward if the income tax return is not filed within the due date? Explain the consequences.

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7.8 LESSON END EXERCISE

1. What is the difference between carry forward and set off of losses under the Income Tax Act?

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2. Which losses can be carried forward?

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3. Discuss the provisions of the Income-tax Act relating to carry-forward of losses, with particular reference to the provisions of Section 72A of the Act.

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7.9 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati

Publication, New Delhi.

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AGGREGATION OF INCOMES

STRUCTURE

8.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand the concept of aggregation of income and its relevance in tax laws.
- Learn what deemed income is and how it's taxed.
- Identify the types of income that must be aggregated under the Income Tax Act.
- Study the legal provisions regarding aggregation and deemed income (Sections 70, 64, etc.).

Learning outcomes

- Explain the principles of aggregation and deemed income.
- Recognize situations where deemed income provisions apply.

- Calculate total income after proper aggregation.
- Apply aggregation and deemed income rules for tax compliance.

8.1 INTRODUCTION

The process of aggregation of income is an essential concept in taxation that involves combining various sources of income to determine the total taxable income of an individual or entity. The idea behind this process is to ensure that all forms of income are accounted for, including those that may not be immediately obvious. Aggregating income is particularly important because it affects the amount of tax liability an assessee (taxpayer) must bear.

In addition to directly earned income, the Income Tax Act also identifies deemed income, which refers to amounts that are treated as income by law, even if they do not technically fall under the definition of income. The aggregation process ensures that such income is also considered for tax purposes. Various provisions, such as sections 68 to 69D, dictate how to handle specific types of income, such as unexplained cash credits, unrecorded investments, or loans repaid through non-banking channels.

Understanding deemed income and how it integrates with other income types ensures tax compliance and avoids potential penalties. This lesson aims to provide a comprehensive overview of aggregation, highlighting key concepts, sections of the Income Tax Act, and the methods used to calculate the total taxable income

8.2 AGGREGATION OF INCOME

Aggregation of Incomes in Income Tax refers to the process of combining different sources of income to determine the total taxable income of an individual or entity. In taxation, the concept of aggregation is crucial because it ensures that all forms of income are accounted for when calculating the total tax liability.

While aggregating the income of an assessee, following are included in the total income:

i. Income of the assessee

ii. Income of other persons to be included in the income of individual i.e. Clubbing of Income (Section 60-65). [Discussed in next lesson]

iii. Income received from firm assessed as Association of Persons or Body of Individual. (Section 66 & 67).

iv. Deemed Incomes (Section 68-69).

8. 3 INCOME RECEIVED FROM AN AOP or BOI

Section 67A of the Income Tax Act deals with the income received from an Association of Persons (AOP) or Body of Individuals (BOI) and specifies the treatment of such income for tax purposes. Here's a breakdown:

- Section 67A states that if a member of an AOP or BOI (other than a Hindu Undivided Family, or HUF) is entitled to a share in the income of the AOP or BOI, that portion of the income is tax-free in the hands of the member.
- However, the AOP or BOI must have already paid income tax on that income. In other words, if the AOP or BOI has been taxed on the income, then the income received by the member is not subject to tax again. This is a rebate or exemption given to avoid double taxation.

So, the income that a member receives from an AOP or BOI is not taxed in their hands under Section 67A, provided that tax has already been paid by the AOP or BOI.

In short: Income from AOP/BOI is tax-free in the hands of the member as long as the AOP/BOI has already paid tax on it.

CHECK THE PROGRESS

Multiple Choice Questions (MCQs)

1. **What is the main purpose of aggregating income in the context of tax laws?**
    - a) To calculate the total tax payable
    - b) To determine the tax-exempt income
    - c) To determine the deductions available
    - d) To avoid double taxation

    Answer: a) To calculate the total tax payable
2. **Which of the following is considered deemed income under Section 69A?**
    - a) Salary income
    - b) Income from unexplained cash credits
    - c) Capital gains from the sale of property
    - d) Unrecorded money, bullion, or jewelry

    Answer: d) Unrecorded money, bullion, or jewelry

3. **In case of income received from an AOP or BOI, the income is taxed in the hands of the member if:**
    - a) The AOP/BOI has not paid tax on the income
    - b) The income is not distributed among members
    - c) The AOP/BOI has paid tax on the income
    - d) The member is a foreigner

    Answer: c) The AOP/BOI has paid tax on the income
4. **Under Section 69D, amounts borrowed or repaid through a hundi are treated as:**
    - a) Capital gains
    - b) Deemed income
    - c) Clubbed income
    - d) Tax-exempt income

    Answer: b) Deemed income
5. **Which of the following statements is true regarding the aggregation of income from an AOP/BOI?**
    - a) The income is included in the member's taxable income even if no tax has been paid by AOP/BOI
    - b) The income is taxed in the hands of AOP/BOI, not the members
    - c) The income is not taxed in the hands of the member if AOP/BOI has paid tax
    - d) The income is exempt from tax altogether

    Answer: c) The income is not taxed in the hands of the member if AOP/BOI has paid tax

8.4 DEEMED INCOME [SECTION 68 – 69]

Deemed Income: Income that is considered to be part of a taxpayer's total income by the tax authorities, even though it may not actually be earned or received. Certain provisions under sections 68-69D of the Income Tax Act specify conditions under which income is deemed, such as unexplained cash credits or investments.

In certain cases, some amounts are deemed as income in the hands of the assessee though they are actually not in the nature of income. These cases are contained in sections 68, 69, 69A, 69B, 69C and 69D. The Assessing Officer may require the assessee to furnish explanation in such cases. If the assessee does not offer any explanation or the explanation offered by the assessee is not satisfactory, the amounts referred to in these sections would be deemed to be the income of the assessee. Such amounts have to be aggregated with the assessee's income.

8.4.1 Cash credits (sec 68)

Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income- tax as the income of the assessee of that previous year.

8.4.2 Unrecorded and Unexplained investments (sec 69)

Where in the financial year immediately preceding the assessment year the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year.

8.4.3 Unrecorded and Unexplained money, etc (Sec 69A)

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, bullion, jewellery or valuable article is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.

8.4.4 Amount of investments, etc., not fully disclosed in books of account (Sec. 69B.)

Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article, and the Assessing Officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial

8.4.5 Unexplained expenditure, etc (Sec. 69C).

Where in any financial year an assessee has incurred any expenditure and he offers no explanation about the source of such expenditure or part thereof, or the explanation, if any, offered by him is not, in the opinion of the Assessing Officer, satisfactory, the amount covered by such expenditure or part thereof, as the case may be, may be deemed to be the income of the assessee for such financial year:

Provided that, notwithstanding anything contained in any other provision of this Act, such unexplained expenditure which is deemed to be the income of the assessee shall not be allowed as a deduction under any head of income.

8.4.6 Amount borrowed or repaid on hundi (Sec. 69D)

Where any amount is borrowed on a hundi from, or any amount due thereon is repaid to, any person otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid for the previous year in which the amount was borrowed or repaid, as the case may be:

Provided that, if in any case any amount borrowed on a hundi has been deemed under the provisions of this section to be the income of any person, such person shall not be liable to be assessed again in respect of such amount under the provisions of this section on repayment of such amount. For the purposes of this section, the amount repaid shall include the amount of interest paid on the amount borrowed.

CHECK THE PROGRESS

True/False Questions

1. **True or False: Deemed income refers to income that is not actually received but is treated as income by the tax authorities.**
   - Answer: True
2. **True or False: Clubbing of income means combining the income of a taxpayer with that of another person under certain conditions.**
   - Answer: True
3. **True or False: If the taxpayer explains the source of unexplained money or assets, then it will not be treated as deemed income under Section 69A.**
   - Answer: True
4. **True or False: Unexplained expenditure can never be treated as deemed income under Section 69C.**
   - Answer: False

8.5 ILLUSTRATION

ILLUSTRATION

Mr. X gifted gold jewelry worth Rs. 100000 to his wife Mrs. X on 1-1-2003.It was acquired on same day. On

1-5-2003 Mrs. X sold this jewelry for Rs 125000 and invested the same in a plot for Rs 240000. The remaining amount was paid by her out of her own funds. The plot was sold for Rs 1200000on 1-11- 2020. Compute the income chargeable to tax in the hands of Mr. X and Mrs. X on the sale of jewelry as well as plot if C.I.I for 2001-02 is 100,for 2003-04 is 109 and for 2020-21 is 301?

SOLUTION

	Rs	
Previous year 2003-04		
Sale price of jewelry	125000	
Less: Cost price	100000	
S.T.C gain to be Mr. X's income		
	25000	
Previous year 2020-21		
Sale price of plot		
	900000	
Less: Indexed cost[240000x301/109]	662752	
L.T.C Gain		237248
Mr. X's income (in the ratio of amount invested)		
[237248*125000/240000]		123567
Mr. X's Income		113681

8.6 LET US SUM UP

In this lesson, we have covered the concept of aggregation of income and its significance in tax law. We explored the various categories of income that must be aggregated for the purpose of calculating an individual's or entity's total taxable income, which includes:

1. Income of the assessee: Direct income from various sources like salary, business, capital gains, etc.
2. Income of other persons (Clubbing of Income): Income from a spouse, minor children, or other related individuals may be included in the total income of the assessee under certain circumstances.
3. Income from AOP/BOI: Income received from an Association of Persons (AOP) or Body of Individuals (BOI), which is tax-free in the hands of the individual member if the entity has already paid taxes on it.
4. Deemed Income: Includes income arising from unexplained sources or transactions, such as

unexplained cash credits, unrecorded investments, and other assets not disclosed properly.

The provisions under sections 68 to 69D outline the legal framework under which these types of income are recognized as deemed income and included in the assessee's total taxable income.

By understanding these provisions, individuals can ensure that all income, including deemed income, is accurately reported and taxed, thereby ensuring compliance with tax laws. Additionally, this lesson highlights how various income components, such as capital gains, are subject to indexing for tax purposes, making the process of aggregation even more precise.

CHECK THE PROGRESS

One-Word Questions

1. **What term is used to describe income that is treated as taxable even though it may not technically be income?**
    - **Answer**: Deemed Income
2. **Which section of the Income Tax Act deals with the treatment of unexplained cash credits?**
    - **Answer**: Section 68
3. **What is the term for the process of combining income from various sources for tax calculation?**
    - **Answer**: Aggregation
4. **Which type of income is treated as tax-free in the hands of the member if the AOP/BOI has already paid tax on it?**
    - **Answer**: Income from AOP/BOI
5. **What is the term used for the legal concept where the income of a spouse or minor child is included in the income of the assessee?**
    - **Answer**: Clubbing

8.7 KEYWORDS

Aggregation of Income: The process of combining various sources of income to calculate the total taxable income of an individual or entity for tax purposes. It ensures that all forms of income are accounted for in the computation of tax liability.

Taxable Income: The amount of income that is subject to taxation after applying deductions, exemptions, and other allowances as per the provisions of the Income Tax Act.

Deemed Income: Income that is considered to be part of a taxpayer’s total income by the tax authorities, even though it may not actually be earned or received. Certain provisions under sections 68-69D of the Income Tax Act specify conditions under which income is deemed, such as unexplained cash credits or investments.

Income from AOP/BOI (Association of Persons/Body of Individuals): Income derived from an AOP or BOI, which is generally a group of individuals who come together for a common purpose. Under section 67A, the income from such an entity is not taxed in the hands of individual members if the entity has already paid tax on the income.

Clubbing of Income: The process of including the income of another person (such as a spouse, minor child, etc.) in the income of an individual under specific conditions as outlined in sections 60-65 of the Income Tax Act.

Section 68 - Cash Credits: A provision under the Income Tax Act that allows the tax authorities to treat unexplained cash credits in the books of an assessee as income. If the taxpayer cannot satisfactorily explain the source or nature of the credits, they are treated as deemed income.

Section 69 - Unrecorded Investments: A provision that deems unrecorded investments in assets (such as property or shares) as income if the taxpayer cannot explain the nature or source of the investment.

Section 69A - Unexplained Money or Assets: A section that deems unexplained money, bullion, jewelry, or other valuable items found with the taxpayer as income if the source or nature of the acquisition cannot be explained satisfactorily.

Section 69B - Excess Investments Not Recorded: This section deals with situations where the taxpayer has made investments or acquired assets (such as bullion or jewelry) but the amounts recorded in the books are less than the actual expenditure incurred. The excess amount is treated as income.

Section 69C - Unexplained Expenditure: A provision that deems any unexplained expenditure as income. If the taxpayer cannot explain the source of the expenditure or if the explanation is unsatisfactory, the expenditure amount is treated as income for tax purposes.

Section 69D - Borrowing or Repayment on Hundi: This section pertains to loans or repayments made through a "hundi" (a traditional financial instrument) outside the banking system. Amounts borrowed or repaid in this manner are deemed to be the taxpayer's income.

8.8 SELF ASSESSMENT QUESTIONS

1. What is the concept of aggregation of income, and why is it necessary in the calculation of total taxable income?

....

....

....

2. Give examples of income that is considered 'deemed income' under the Income Tax Act.

....

....

……

3. How is deemed income taxed, and what are the legal implications for taxpayers who fail to report it?

……

……

……

8.9 LESSON END EXERCISE

1. Explain the provisions of Section 70 of the Income Tax Act concerning the aggregation of losses and incomes.

……

……

……

2. Explain Deemed income. Elaborate the incomes that are treated as deemed incomes.

……

……

……

3. What is deemed income, and how does it differ from actual income in terms of taxation?

……

……

……

8.10 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

UNIT – II **B.COM 4th SEMESTER**

COURSE No. BCG-402 **LESSON No. 9**

CLUBBING OF INCOMES

STRUCTURE

9.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand the meaning and application of clubbing of income.
- Study relevant sections of the Income Tax Act related to clubbing.
- Identify which types of income are subject to clubbing.
- Learn how to apply clubbing provisions in real tax scenarios.

Learning outcomes

- Explain when and why income is clubbed under tax laws.
- Recognize exceptions where clubbing doesn’t apply.
- Correctly calculate tax liability after clubbing income.
- Use clubbing rules for effective tax planning and compliance

9.1 INTRODUCTION

Clubbing of income is a provision under the Income Tax Act that requires certain types of income earned by individuals or family members to be included in the income of the taxpayer. This concept aims to prevent tax avoidance through the manipulation of income distribution among family members. The provisions primarily target cases where one person, typically a taxpayer, transfers assets or income to others, such as a spouse, minor child, or relative, in an attempt to reduce tax liability. The clubbing of income ensures that income from these sources is appropriately taxed by clubbing it with the taxpayer's income. By enforcing these rules, the law aims to maintain fairness and prevent taxpayers from circumventing their tax obligations by shifting income to others.

9.2 MEANING OF CLUBBING OF INCOME

Clubbing of income means Income of other person included in assesse’s total income, for example: Income of husband which is shown to be the income of his wife is clubbed in the income of Husband and is taxable in the hands of the husband. Under the Income Tax Act a person has to pay taxes on his income. A person cannot transfer his income or an asset which is his one of source of his income to some other person or in other words we can say that a person cannot divert his income to any other person and says that it is not his income. If he do so the income shown to be earned by any other person is included in the assessee’s total income and the assessee has to pay tax on it. Inclusion of other’s Incomes in the income of the assessee is called Clubbing of Income.

As the term suggests, clubbing of income means adding or including the income of another person (mostly family members) to one’s own income. This is allowed under Section 64 of the IT Act. However, certain restrictions pertaining to specified person(s) and specified scenarios are mandated to discourage this practice.

9.3 SPECIFIED PERSONS TO CLUB INCOME

Income of any and every person cannot be clubbed on a random basis while computing total income of an individual and also not all income of specified person can be clubbed. As per Section 64, there are only certain specified income of specified persons which can be clubbed while computing total income of an individual.

CHECK THE PROGRESS

Multiple Choice Questions (MCQs)

1. **What does the concept of "Clubbing of Income" refer to?**
    - A) Income earned by an individual’s spouse
    - B) Income earned by a minor child
    - C) Income transferred to another person
    - D) Both B and C

Answer: D) Both B and C

2. **Under the Income Tax Act, income of a spouse is clubbed with the income of the individual if the transfer of income is made without adequate consideration. This provision is applicable under which section?**
    - A) Section 10
    - B) Section 64
    - C) Section 80
    - D) Section 115

Answer: B) Section 64

3. **Which of the following is not a case of income clubbing?**
    - A) Income from a minor child’s investments
    - B) Income from the transfer of assets to the spouse
    - C) Income from a trust created by a deceased person
    - D) Income from a property inherited from a relative

Answer: D) Income from a property inherited from a relative

4. **Income of a minor child is clubbed with the income of which of the following persons?**
    - A) Mother
    - B) Father
    - C) Both parents if the income is transferred by them
    - D) Either parent

Answer: D) Either parent

5. **Income from which of the following is not subject to clubbing provisions?**
    - A) Income from assets transferred to spouse
    - B) Income from minor child’s investments
    - C) Income from assets transferred to a son-in-law
    - D) Income from assets transferred to a minor grandchild

Answer: C) Income from assets transferred to a son-in-law

9.4 SPECIFIED SCENARIOS TO CLUB INCOME

Incomes of other persons to be included in the income of individual (Section 60-65).

Section 60-65 deal with such cases where a particular income is earned or received by another person and does not belong to the assessee but for Income-Tax purposes, such incomes are included in the total income of the assessee.

1. **Transfer of income without transfer of Asset[Section 60]**: If any person transfers income without transferring the ownership of the asset, such income will be taxable in the hands of the transferor. Ex. X owns 4000, 14% debentures of A ltd. of Rs. 100 each , he transfers interest income to his friend Y without transferring the ownership of Debentures . In this case although interest will be received by Y but it is taxable in the hands of X.

2. **Revocable transfer of Asset[Section 61]**: If any person transfers any asset to any other person in such form and condition that such transfer is revocable at any time during the lifetime of the transferee , the income earned through such asset is chargeable to tax as the income of the transferor. For ex. X transfers a house property to A. However, X has right to revoke the transfer during the life time of A . It is a revocable transfer and income arising from the house property is taxable in the hands of X.

3. **Remuneration to Spouse[Section 64(1)(ii)]**: An individual is chargeable to tax in respect of any remuneration received by the spouse from a concern in which the individual has *substantial interest. This provision has an exception. If the remuneration is received by spouse by the application of technical or professional knowledge or experience clubbing provisions will not take place. For ex. X has substantial interest in A ltd. and Mrs. X is employed by A ltd. without any technical or professional qualification. In this case salary income of Mrs. X shall be taxable in the hands of X.

4. **Income from assets transferred to spouse[Section 64(1)(iv)]**: Where an asset is transferred by an individual to his spouse directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart, any income from such asset is deemed to be the income of the transferor. For ex. Mrs. A transfer's 100 debentures of IFCI to her husband without adequate consideration. Interest income on these debentures will be included in the income of Mrs. A.

5. **Income from asset transferred to son's wife[Section 64(1)(vi)]**: If an individual, directly or indirectly transfers asset, without adequate consideration to son's wife, income arising from such asset is included in the income of the transferor. For ex. Mrs. A transfer's 100 debentures of IFCI to her son's wife without adequate consideration. Interest income on these debentures will be included in the income

of Mrs. A.

6. Income from asset transfer to a person for the benefit of spouse/ son's wife [Section 64(1)(vii)]: If an individual, directly or indirectly transfers asset, without adequate consideration to a person or an association of persons for the benefit of his/her spouse /son's wife, income arising from such asset directly or indirectly is included in the income of the transferor. For Ex. X transfers Government bonds without consideration to an association of persons, subject to the condition that the interest income from these bonds will be utilized for the benefit of Mrs. X or Mrs. X son's wife. Interest from bonds will be included in the income of X

7. Income of a minor child [Section 64(iA)]: All income which arises to the minor shall be clubbed in the income of his parents. Income will be included in the income of that parent whose total income is greater. This case has two exceptions.

1. Income of minor child suffering from specified disability.
2. Income of minor child on account of manual work or involving application of his skill/talent etc.

***Substantial Interest:** An individual is deemed to have substantial interest if he beneficially holds equity shares carrying not less than 20% voting powering case of a company or is entitled to not less than 20% of the profits in case of a concern other than a company , at any time during the previous year.

Some special points to remember:

1. If an individual makes a gift in cash or by cheque to his spouse and that money is utilized by the spouse for purchase of an asset. The income earned by the spouse from that asset will not be clubbed in the income of the individual.

2. In order to invoke clubbing provisions there must be relation of husband and wife. That means if a person transfers asset to his would be spouse before marriage income arising from such asset will not be included in the income of transferor.

3. Negative income is also income. Under the Income Tax Act income does not means positive income only. The term income includes negative income or loss also.

4. Income from accretion to asset is not taxable in the hands of the transferor.

5. Income from saving out of pin money is not included in the income of husband.

6. Income of minor child is clubbed with the income of the parent whose income after excluding the

share of minor's income is greater.

7. If trust is created for the benefit of minor child and income during minority of child is being accumulated and added to corpus of trust and income from increased corpus is given to the child after attaining majority, clubbing provisions are not applicable.

Section	**Specified person**	**Specified scenario**	**Income to be clubbed**
Section 60	Any person	Transferring income without transferring asset either by way of an agreement or any other way,	Any income from such asset will be clubbed in the hands of the transferor
Section 61	Any person	Transferring asset on the condition that it can be revoked	Any income from such asset will be clubbed in the hands of the transferor
Section 64(1A)	Minor child	Any income arising or accruing to your minor child where child includes both step child and adopted child. The clubbing provisions apply even to minor married daughter.	Income will be clubbed in the hands of higher earning parent. Note: If the marriage of the child's parents does not subsist, income shall be clubbed in the income of that parent who maintains the minor child in the previous year. If a minor child's income is clubbed in the hands of parent, then an exemption of Rs. 1,500 is allowed to the parent (This is applicable only if the parent opts for the old tax regime). Exceptions to clubbing Income of a disabled child (disability of the nature specified in section 80U) Income earned by manual work done by the child or by activity involving the application of his skill and talent or specialised knowledge and experience Income earned by a major child. This would also include income earned from investments made out of money gifted to

			the adult child. Also, money gifted to an adult child is exempt from gift tax under gifts to ‘relative’.
Section 64(1)(ii)	Spouse**	If your spouse receives any remuneration irrespective of its nomenclature, such as Salary, commission, fees or any other form and by any mode, i.e., cash or in kind from any concern in which you have substantial interest*	Income shall be clubbed in the hands of the taxpayer or spouse, whose income is greater (before clubbing). An exception to clubbing: Clubbing is not allowable if spouse possesses technical or professional qualifications in relation to any income arising to the spouse, and such income is solely attributable to the application of his/her technical or professional knowledge and experience.
Section 64(1)(iv)	Spouse**	Direct or indirect transfer of assets to your spouse by you for inadequate consideration	Income from such asset is clubbed in the hands of the transferor. Provided the asset is other than the house property. Exceptions to clubbing of income in the following cases: a. Where the asset is received as part of divorce settlement b. If assets are transferred before marriage, c. No husband and wife relationship subsists on the date of accrual of income. d. The asset is acquired by the spouse out of pin money (i.e. an allowance given to the wife by her husband for her personal and usual household expenses)
64(1)(vi)	Daughter-in-law	Transfer of assets transferred directly or indirectly to your daughter in-law by you for inadequate consideration	Any income from such assets transferred is clubbed in the hands of the transferor

64(1)(vii)	Any person or association of person	Transferring any assets directly or directly for an inadequate consideration to any person or association of persons to benefit your daughter in-law either immediately or on deferred basis	Income from such assets will be considered as your income and clubbed in your hands
64(1)(viii)	Any person or association of person	Transferring any assets directly or directly for an inadequate consideration to any person or association of persons to benefit your spouse either immediately or on deferred basis	Income from such assets will be considered as your income and clubbed in your hands
Section 64(2)	Hindu Undivided Family	In case, a member of HUF transfers his individual property to HUF for inadequate consideration or converts such property into HUF property	Income from such converted property shall be clubbed in the hands of individual

***An individual is said to have the substantial interest in the concern if–**

- In case of a company, individual either by himself or along with his relative/s beneficially owns shares having 20% or more voting power (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits)
- In any other case, such individual either alone or along with his relative/s is entitled to 20% or more of profits in the aggregate of such concern at any time during the previous year.

****Income from reinvestment of clubbed income by a spouse is not clubbed in the hands of individual.**

9.5 EXAMPLES ON CLUBBING OF INCOME

Example 1

Mr P owns a shop which fetches a rent of Rs.12,000 per month. He transfers the rent to his friend Mr Q but retains the ownership of the shop.

In this case, because Mr P has transferred the income without transferring the asset. Hence, as per section 60 of the income tax act, Mr P must include the rental income while computing his total income.

Example 2

Mr Jay is beneficially holding 21% equity shares of PTK Pvt. Ltd. Mrs Jay is employed as a finance manager in PTK Pvt. Ltd. The monthly salary received from Mrs PTK Pvt. ltd. is Rs. 40,000. Mrs Jay is not having any qualification, experience or knowledge of finance.

In this situation, Mr Jay has a substantial interest in PTK Pvt. Ltd. with 21% shareholding. But Mrs Jay is employed without any qualification and technical knowledge of finance. Hence, salary or payment received by Mrs Jay from PTK Pvt. Ltd. will be clubbed with the income of Mr Jay as per section 64(1)(ii) of the income tax act.

In the above case, if Mrs Jay had the qualification and knowledge for the finance manager post in PTK Pvt. ltd., then income earned by Mrs Jay will not be clubbed in the income of Mr Jay.

Example 3

Mr Lucky holds gifted Rs. 6,00,000 to his wife. Mrs Lucky has then invested the same amount in the fixed deposit. Mrs lucky receives the interest of 5,000 p.a. from such fixed deposit.

As Mr Lucky has transferred Cash (asset) without adequate consideration and it was converted into another asset by Mrs Lucky. Hence, interest earned of Rs. 5,000 from the converted asset (fixed deposit) will be clubbed in the income of Mr Lucky as per section 64(1)(iv) of the income tax act.

Note:

- If Mr lucky transfers the cash as a settlement for divorce in the above case, then clubbing provisions will not apply.
- Also, if he transfers the cash before marriage and interest is accrued after marriage, no income shall be clubbed in the hands of Mr. Lucky.

Hence, husband-wife relationship should remain at the time of transfer of asset and also at the time of accrual of income.

CHECK THE PROGRESS

True/False

1. Income of a minor child from a scholarship is clubbed with the parent’s income.
   - **Answer**: False
2. The income of a spouse is always clubbed with the income of the transferor if the transfer was made with adequate consideration.
   - **Answer**: False
3. Clubbing provisions do not apply to income transferred to a minor grandchild.
   - **Answer**: True

4. If a parent transfers an asset to a minor child, the income from that asset is not clubbed with the parent's income.
    - **Answer**: False
5. Under clubbing provisions, if a husband transfers an asset to his wife and the income generated from it is substantial, it will be clubbed with the husband's income.
    - **Answer**: True

9.6 HOW TO AVOID CLUBBING OF INCOME

Now we have explained the provision where transaction which are considered under clubbing of income, Lets explain some of unique ways you can plan your taxes without clubbing of Income provision

1. **Transfer of amount to Parents and Interest earned on such investment :** Any amount transferred to your Parents as a Gift will not be taxable in the hands of your Parents and lets say such amount is invested in a Fixed Deposit , Interest on such FD will continue to be taxed in the hands of Parents and clubbing provision will not be applicable
2. **Gift Received at the time of Marriage:** Any gift received during the time of marriage will not be taxable in the hands of the recipient and thus any income arising on such investment will continue to be taxed in the hands of the recipient.
3. **Investment in PPF:** Since interest earned on PPF is exempt income , Even if you invest in PPF in the name of your Spouse or Minor child , Interest will not be taxable. Thus clubbing provision became irrelevant.

Since there is an investment cap of Rs 150,000 per individual in PPF , You can open multiple PPF accounts in the name of your Spouse or Minor child to get this benefit

9.7 THINGS TO REMEMBER

- The clubbing provision applies to Income and loss both.
- Capital gain on further transfer of the asset by the transferee will be considered as income and it shall be clubbed in the income of transferor.
- The income derived from the converted form of asset shall be clubbed in the hands of transferor.
- If part consideration is payable or paid, then only the inadequate consideration will be clubbed in the hands of the transferor
- The clubbing provisions will not apply on the income derived from the clubbed income.

For example: If a bond is transferred for Rs. 5 lakh to the spouse or daughter-in-law without adequate consideration and interest of Rs. 20,000 on such bond is clubbed in the hands of the transferor. However, if the spouse or daughter-in-law further earns any income from such interest of Rs. 20,000, no clubbing provisions shall apply on such income.

- The clubbing provisions will apply for indirect transfers or cross transfers as well.

For example: If Mr K gifts a sum of Rs. 8,000 to Mrs. N and Mr. N gifts a sum of Rs. 15,000 to Mrs. K. Say both the gifts are without any consideration. Then the overlapping amount of Rs. 8,000 will be clubbed in the hands of the transferors.

Disclosure in ITR Form

Any individual having income as per provision of Section 60 to 64 due to clubbing provision then specific disclosure needs to be provided. It is important to note that Individual taxpayers will have to use ITR -2 /3 if they have any income to be considered under clubbing provision.

Such income which is accrued in the name of Spouse , Child or other individual which is subject to clubbing provision needs to be declared in Total Income (In respective head of income) and separate disclosure is required in Schedule SPI in the below ITR Format

Schedule SPI	Income of specified persons (spouse, minor child etc.) includable in income of the assessee as per section 64					
	Sl No	Name of person	PAN/ Aadhaar No. of person (optional)	Relationship	Amount (Rs)	Head of Income in which included
	1					
	2					
	3					

9.8 IILUSTRATION

Mr. John's income computed under the head salaries is 269500.Last year he received arrears of salary and gifted 125000out of these to his wife. Mrs. John invested on 1-1-2020 Rs 500000 in 15% debentures issued by a company.u

These debentures were financed by Mrs. John as under:

a) Rs 125000 received as gift from Mr. John

b) Rs. 300000 lout of her sitridhan.

c) Rs. 75000 as loan taken from bank. Rate of interest is 18% p.a.

On 1-1-2021 the company paid interest to Mrs. John .She invested this interest in a fixed deposit with a bank @12% p.a. interest for the period 1-1-2021 to 31-3-2021 was Rs. 2250.

Compute the Gross Total Income of Mr. John and Mrs. John for the previous year 2015-16 explaining all the points clearly.

SOLUTION

A. Gross total Income of Mr. John **RsRs**

Salaries

Computed Income

Other sources

Interest on debenture on the name of wife but u/s 64(1)(iii)

To be clubbed with Mr. John income)

[500000x15%=75000x125000/500000] 18750

G.T.I **288250**

B. Gross Total Income of Mrs. John

Income from other sources

Interest on debenture(75000x375000/500000) 56250

Less: ded. For interest on loan taken from bank

[75000x18/100x1year] 13500

42750

Interest on Bank deposit 2250

G.T.I **45000**

Note: In case the income of the gifted asset is reinvested, any further income from such reinvestment remains transferee's income.

CHECK THE PROGRESS

Fill in the Blanks

1. The income of a minor child from ________ is clubbed with the parent's income.

    Answer: investments

2. According to Section 64 of the Income Tax Act, the income from assets transferred to a ________ is clubbed with the income of the transferor.

    Answer: spouse

3. If the transfer of assets is made to the spouse for ________, the income from that asset will be clubbed with the transferor's income.

    Answer: inadequate consideration

4. The income of a minor child is not clubbed with the parent's income if it is earned from the child's _________.

    Answer: manual work

9.9 LET US SUM UP

The clubbing of income provisions ensure that taxpayers cannot evade taxes by simply redistributing their income among family members. While these provisions are designed to protect the tax system from abuse, they also offer clear guidelines on how income is to be treated when it is transferred or earned by family members. It is important for taxpayers to understand the nuances of clubbing provisions, as failure to comply can lead to unintended tax liabilities. By effectively applying these rules, individuals can better manage their tax affairs and avoid penalties, ensuring fair taxation in cases of income shifting within families.

9.10 KEYWORDS

Transfer of Income (section 60): Where a person transfers to any other person income (whether revocable or not) from an asset without transferring that asset, the income shall be included in the total income of the transferor. "Transfer" includes any settlement, trust, covenant, agreement or arrangement.

Revocable transfer: Where a person transfers any asset to any other person with a right to revoke the transfer, all income accruing to the transferee from the asset shall be included in the total income of the transferor.

The income under revocable transfer of asset shall be included in the income of transferor even when only a part of income from transferred asset has been applied for the transferor.

Irrevocable Transfer: In case of an irrevocable transfer of assets for a specified period, the income from such assets shall not be included in the income of transferor.

Income to spouse from a concern in which such individual has substantial interest [Section 64(1)(ii)]: All such income as arises directly or indirectly, to the spouse of an individual by way of salary, commission, fees or any other remuneration, whether in cash or kind from a concern in which such individual has a substantial interest, shall be included in the income of the individual.

Income to spouse from the assets transferred [Section 64(1)(iv)]: Where any individual transfers directly or indirectly any asset (other than a house property) to the spouse, the income from such asset shall be included in the income of the transferor.

Income to Son's Wife [Section 64(1)(vi)]: Where any individual transfers, directly or indirectly, any asset to his/her son's wife without adequate consideration, after 1.6.1973, the income from such asset shall be included in the income of the transferor.

Transfer for Immediate or Deferred Benefit of Son's Wife [Section 64(1)(viii)]: Any income arising, directly or indirectly, to any person or association of persons from assets transferred directly or indirectly after June 1, 1973, otherwise than for adequate consideration to the person or association of persons by such individual shall, to the extent to which the income from such assets is for the immediate or deferred benefit of his son's wife be included in computing the total income of such individual.

Income to spouse through a third person [Section 64(1)(Vii)]: Where a person transfers some assets directly or indirectly to a person or association of persons (trustee or body of trustees or juristic person) without adequate consideration for the immediate or deferred benefit of his or her spouse, all such income as arises directly or indirectly from assets transferred shall be included in the income of the transferor.

Clubbing of Income of Minor Child [Section 64(1a)]: All income which arises or accrues to the minor child (not being a minor child suffering from any disability of the nature specified in Section 80U) shall be clubbed in the income of his parent. However, any income which is derived by the minor from manual work or from any activity involving application of his skill, talent or specialised knowledge and experience will not be included in the income of his parent. In case the income of an individual includes any income of his minor child in terms of this section [i.e. Section 64(1A)], such individual shall be entitled to exemption of the amount of such income or Rs. 1,500 whichever is less.

9.11 SELF ASSESSMENT QUESTIONS

1. What is the concept of clubbing of income, and why is it important in tax law?

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2. Under which circumstances can the income of a spouse, minor child, or other family members be clubbed with the taxpayer's income?

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3. Explain the provisions of clubbing of income as per Section 64 of the Income Tax Act.

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9.12 LESSON END EXERCISE

1. What are the exemptions and exceptions under the clubbing of income rules?

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2. Enumerate the various rebates and reliefs available to under the Income-tax Act, 1961.

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3. How does the clubbing of income impact the computation of total taxable income for an individual?

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9.13 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

UNIT – II | B.COM 4th SEMESTER

COURSE No. BCG-402 | LESSON No. 10

DEDUCTIONS FROM GROSS TOTAL INCOME

STRUCTURE

10.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- To understand the concept and importance of deductions in income tax computation.
- To identify the various sections under Chapter VI-A that offer deductions from 80 C to 80 U .
- To learn the eligibility criteria, limits, and conditions for claiming different deductions.
- To analyze the impact of deductions on reducing taxable income and tax liability.
- To develop skills to apply deduction provisions practically while filing income tax returns

Learning outcomes

- Define what deductions are and explain their role in income tax calculation.
- List key deduction sections such as 80C, 80D, 80E, and 80G and describe their features.
- Determine eligibility and maximum limits for various deductions under income tax law.
- Compute taxable income by appropriately applying deductions to gross total income.
- Make informed decisions on tax-saving investments and expenses based on deduction provisions.

10.1 INTRODUCTION

The deductions chapter of the Income Tax Act, 1961 provides taxpayers with opportunities to reduce their taxable income through various allowances and exemptions. These deductions are aimed at encouraging individuals to engage in activities that benefit both themselves and society, such as investing in savings schemes, purchasing health insurance, contributing to charitable causes, and saving for retirement. The deductions available under the Act are primarily governed by Chapter VI-A, which contains a range of sections that allow for reductions based on specific expenditures or investments. By offering these deductions, the government provides relief to taxpayers, enabling them to lower their tax liability and incentivizing behaviors that contribute to financial security and social welfare.

Sections such as 80C, 80D, and 80G are some of the most commonly used for tax-saving purposes. Section 80C allows deductions for investments like PPF, life insurance premiums, and ELSS, while Section 80D provides relief for premiums paid towards health insurance. Section 80G allows deductions for donations to eligible charitable organizations. In addition, there are provisions like Section 80E for interest on loans for higher education and Section 80TTA/80TTB for savings interest. These deductions not only reduce the overall tax burden but also promote long-term financial planning and social responsibility. Understanding these provisions is essential for taxpayers to maximize their tax-saving potential while complying with the law.

10.2 DEDUCTIONS TO BE MADE FROM GROSS TOTAL INCOME

The deduction from gross total income is available only where the gross total income is positive. If however income is negative, the question of any deduction does not arise. Section 80A to 80 U of the Income-tax Act lays down the provisions relating to the deductions available to assessees from their gross total income. Deductions are available in two categories:

a. Deduction in respect of certain payments (section 80C to 80GGC).
b. Deduction in respect of certain incomes (section 80IA to 80U).

CHECK THE PROGRESS

True or False

1. Section 80C allows a deduction for tax paid on salary.
   - **Answer: False** (Section 80C allows deductions for specified investments and expenses, not tax paid on salary.)

2. Under Section 80D, health insurance premiums paid for family members are eligible for a deduction.
    - **Answer: True**
3. Section 80U provides a deduction for individuals with disabilities.
    - **Answer: True**
4. Deductions under Section 80E for interest on educational loans are only available for loans taken for undergraduate studies.
    - **Answer: False** (Deductions are available for loans taken for any level of education, not just undergraduate.)

10.3 DEDUCTIONS IN RESPECT OF CERTAIN PAYMENTS

10.3.1 Deduction regarding approved savings in P.F., LIC Premium etc (80C)

Eligible assesses: Individual and HUF

Entitlement: Deduction from the Gross Total Income of an amount equal to the investments made, subject to a maximum amount of Rs. 150,000.

Nature of Investments:

a. Life Insurance policy taken on the life of an individual assessee or spouse and any child of such individual, and any member of the Hindu Undivided Family.

b. Amounts paid to effect or to keep in force a contract for a non-cumulative deferred annuity not being an annuity plan.

c. Deduction from the salary payable by or on behalf of the Government to any individual, in accordance with the conditions of his service, for securing to him a deferred annuity or making provision for his wife or children, to the extent of one-fifth of salary.

d. Any contribution made by an individual only to any provident fund to which the Provident Funds Act, 1925, applies; a Recognised provident fund; an approved superannuation fund.

e. Subscription to the notified securities of the Central Government.

f. Any contribution to a PPF by individual or HUF.

g. Subscription to other notified savings certificates defined in Section 2(c) of the Government Savings Certificates Act, 1959.

h. Contributions made by an individual or HUF, for participation in the Unit-Linked Insurance Plan, 1971.

i. Any contribution to effect or keep in force any notified annuity plan of the LIC or any other insurer.

j. Any subscription, to any units of any Mutual Fund or the Unit Trust of India under any notified plan formulated by the Central Government.

k. Subscription to the notified deposit scheme of or contribution to any such pension fund set up by the National Housing Bank established under Section 3 of the National Housing Bank Act, 1987.

l. Tuition fees (excluding any payment towards any development fees or donation or payment of similar nature), whether at the time of admission or thereafter, to any university, college, school or other educational institution situated within India;

m. For purchase or construction of a residential house property, the income of which is chargeable to tax under the head “Income from House Property”, where such payments are made towards or by way of:

a. Any instalment or part payment of the amount due under any self- financing or other scheme of any development authority, housing board or other authority engaged in the construction and sale of house property on ownership basis; or

b. Any instalment or part payment of the amount due to any company or cooperative society of which the assessee is a shareholder or member towards the cost of the house property allotted to him; or

c. Re-payment of the amount borrowed by the assessee from:

(1) The Central Government or any State Government; or

(2) Any bank, including a co-operative bank, or

(3) The Life Insurance Corporation, or

(4) The National Housing Bank, or

(5) Any public company formed and registered repayment of principal part only not interest in India with the main object of carrying on the business of providing long-term finance for the construction or purchase of houses in India for residential purposes, eligible for deduction under Section 36(1)(viii), or

(6) Any company in which the public are substantially interested or any co-operative society, where such company or co-operative society is engaged in the business of financing the construction of

houses; or

(7) The assessee's employer where suchemployer is a public company or a public sector company or a university established by law or a college affiliated to such university or a local authority or a cooperative society;

(8) The assessee's employer where such employer is an authority or a board or a corporation or any other body established under a Central or State Act (w.e.f. A.Y. 2006-07).

d. Stamp duty, registration fee and other expenses for the purpose of transfer of such house property to the assessee.

n. Subscription to equity shares or debentures or units forming part of any eligible issue of capital.

o. Fixed deposits for a minimum period of 5 years in any Scheduled Banks (w.e.f. A.Y. 2007-08).

p. As subscription to such bonds issued by the National Bank for Agriculture and Rural Development, as the Central Government may, by notification in the Official Gazette specify in this behalf.

q. In an account under the Senior Citizens Savings Scheme Rules, 2004.

r. As five year time deposit in an account under the Post Office Time Deposit Rules, 1981.

10.3.2 Deduction in respect of contribution to certain pension funds persons

(80CCC)

Covered- individual.

Eligible Amount- Deposit or payment made to LIC or any other insurer in the approved annuity plan for receiving pension.

Extent of Deduction- Least of amount paid or Rs. 1,50,000/- .

10.3.3 Deduction in Respect of Contribution to Pension Scheme of Central Govt., or of any other Employer (80CCD).

Covered - Individual.

Eligible Amount: the amount of deduction shall be as follows

1. For employees (Govt., or Non-Govt.,): Employees own contribution or 10% of salary whichever is less and contribution of central govt. / other employer or 10% of salary whichever is less.

2. For other employees (self-employed): depositors own contribution or 10% of gross total income, whichever is less.

The maximum amount of deduction u/s CCD is Rs 1,50,000 only.

10.3.4 Deduction in respect of investment made under any notified saving scheme (80CCG)

Deduction is allowed if the following conditions are satisfied:

1. The assessee is a resident individual.

2. His gross total income does not exceed 12 Lakh.

3. He has acquired listed shares or listed units of an equity oriented funds in accordance with a notified scheme

4. The investment is locked in for a period of 3 years from the date of acquisition in accordance with the above scheme.

5. The assessee satisfies any other condition as may be prescribed.

If the above conditions are satisfied, a deduction will be allowed under section 80CCG. The amount of deduction is 50% of the amount invested in equity shares. However, the amount of deduction under this section cannot be more than ` 25,000. The deduction shall be allowed for 3 consecutive assessment years beginning with assessment years in which listed equity shares or units were first acquired.

10.3.5 Deductions in Respect of Medical Insurance Premia (80D)

Deduction regarding health insurance is allowed to individuals and HUFs. Where the assessee is an individual, the sum referred to in sub-section (1) shall be the aggregate of the following:

(a) the whole of the amount paid to effect or to keep in force an insurance on the health of the assessee or his family or "any contribution made to the Central Government Health Scheme" or such other scheme as may be notified by the Central Government in this behalf or any payment made on account of preventive health check-up of the assessee or his family and the sum does not exceed in the aggregate Rs 25000 (Rs 30000 in case of senior citizens); and

(b) 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 any payment made on account of preventive health check-up of the assessee or his family as does not exceed in the aggregate RsRs 25000 (Rs 30000 in case of senior citizens). The deduction in respect of payment made on account of preventive health check up shall not exceed Rs 5,000.

Where the assessee is a Hindu undivided family, the sum referred to in sub-section (1) shall be the 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 25000 (Rs 30000 in case of senior citizens).

10.3.6 Deductions in respect of maintenance including medical treatment of a dependent who is a person with disability (80DD)

Persons Covered- Resident Individual/HUF.

Eligible Amount-

(a) Expenditure incurred on medical treatment [including nursing], training and rehabilitation of a disabled dependent, or

(b) Any payment or deposit made under a scheme framed by LIC or any other insurer or the administrator or the specified company and approved by the Board for payment of lump sum amount or annuity for the benefit of dependent with disability.

Extent of Deduction: (a) Rs. 75,000/- in case of normal disability or (b) Rs. 125,000/- in case of severe disability.

10.3.7 Deduction in respect of medical treatment, etc. (80DDB)

An individual *(less than 60 years of age)* can claim up to Rs 40,000 for the treatment of specified critical ailments. This can also be claimed on behalf of the dependents. The tax deduction limit under this section for Senior Citizens is Rs 60,000 and for very Senior Citizens *(above 80 years)* the limit is Rs 80,000.

To claim Tax deductions under Section 80DDB, it is mandatory for an individual to obtain ‘Doctor Certificate’ or ‘Prescription’ from a specialist working in a Govt. or Private hospital.

For the purposes of section 80DDB, the following shall be the eligible diseases or ailments:

- Neurological Diseases where the disability level has been certified to be of 40% and above;

(a) Dementia
(b) Dystonia Musculorum Deformans
(c) Motor Neuron Disease
(d) Ataxia
(e) Chorea
(f) Hemiballismus
(g) Aphasia
(h) Parkinson's Disease

- Malignant Cancers
- Full Blown Acquired Immuno-Deficiency Syndrome (AIDS) ;
- Chronic Renal failure
- Hematological disorders
    - Hemophilia
    - Thalassaemia

10.3.8 Deduction in respect of interest on loan taken for education (80E).

Persons Covered- Individual.

Extent of Deduction- Entire amount of interest.

Eligible Amount- Any amount paid by way of interest on loan taken from any financial institution or any approved charitable institution for his/her higher education or w.e.f. 14-2008 for the purpose of higher education of his/her spouse, children and legal guardian of the Individual. Relevant Conditions/Points:

1. Amount should be paid out of income chargeable to tax.

2. All field of studies including vocational studies pursued after passing the senior secondary examination or its equivalent from any school, board or university recognized by the central govt. or

state govt. or local authority or by any other authority authorised by the central govt. or state govt. or local authority to do so.

3. Approved charitable institution means an institution established for charitable purposes and notified by the Central Government u/s. 10(23C) or referred in 80G(2)(a).

4. Financial institution means banking company or financial institution notified by Central Government.
5. The deduction is allowed in the initial assessment year (i.e., the assessment year relevant to the previous year, in which the assessee starts paying the interest on loan) and 7 assessment years. Immediately succeeding the initial assessment year or until the interest is paid in full whichever is earlier.

10.3.9 Deduction In Respect of Donations to Certain Funds, Charitable Institutions, Etc. (80G)

Persons Covered-All assessees [except for 80G (2)(c), which is applicable for donations made only by company] to the Indian Olympic Association or to any other Association or Institution for the development of infrastructure for sports & games or the sponsorship of sports & games, in India.

Eligible Amount- Any sums paid in the previous year as Donations to certain funds, charitable institutions etc. specified u/s. 80G (2).

Relevant Conditions/Points

1. Donation in kind is not eligible for deduction.

2. Donations paid out of another year's income or out of income not includible in the assessment of current year are also eligible for deduction. Lt. F. No. 45/313/66 – ITJ (61) dt. 2-12-1966.

Extent of Deduction

Without any ceiling of 10% of adjusted Gross Total Income:—

(a) 100% of donation if donation given to

(i) National Defence Fund set up by the Central Government;

(ii) Prime Minister's National Relief Fund;

(iii) Prime Minister's Armenia Earthquake Relief Fund;

(iv) Africa (Public Contributions — India) Fund;

(v)National Foundation for Communal Harmony;

(vii) An approved university/educational institution of National eminence;

(viii) The Maharashtra Chief Minister's Relief Fund

(ix) Chief Minister's Earthquake Relief Fund, Maharashtra;

(x) Any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of earthquake in Gujarat;

(xi) Any Zila Saksharta Samiti constituted in any district under the chairmanship of the Collector of that district;

(xii) National Blood Transfusion Council or to any State Blood Transfusion Council;

(xiii) Any fund set up by a State Government for the medical relief to the poor;

(xiv) The Army Central Welfare Fund or the Indian Naval Benevolent Fund or the Air Force Central Welfare Fund,

(xv) Andhra Pradesh Chief Minister's Cyclone Relief Fund, 1996;

(xvi) National Illness Assistance Fund;

(xvii) Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund in respect of any State or Union Territory;

(xviii) National Sports Fund;

(xix) National Cultural Fund;

(xx) Fund for Technology Development and Application;

(xxi) National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities;

(xxii) Any trust, institution or fund to which Section 80G(5C) applies for providing relief to the victims of earthquake in Gujarat (contribution made during January 26, 2001 and September 30, 2001) **or**

(b) 50% of donation if donation given to:

Jawaharlal Nehru Memorial Fund; Prime Minister's Drought Relief Fund; National Children's Fund(deduction shall be allowed 100% w.e.f. A.Y 2014- 15); Indira Gandhi Memorial Trust; Rajiv Gandhi Foundation.

With ceiling of 10% of adjusted Gross Total Income:—

Where the aggregate of sums exceed 10% of adjusted gross total income, then such excess amount is ignored for computing such aggregate.

(a) 100% of qualifying amount, if donation given to Government or any approved local authority, institution or association to be utilised for the purpose of promoting family planning; Donation by a Company to the Indian Olympic Association or to any other notified association or institution established in India for the development of infrastructure for sports and games in India or the sponsorship of sports and games in India.

(b) 50% of qualifying amount if donation given to any other fund or any institution which satisfies conditions mentioned in Section 80G(5); Government or any local authority to be utilised for any charitable purpose other than the purpose of promoting family planning, Any authority constituted in India for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns, villages or both; Any corporation referred in Section 10(26BB) for promoting interest of minority community; For repairs or renovation of any notified temple, mosque, gurudwara, church or other place.

10.3.10 Deduction in respect of expenditure incurred on payment of house rent (80GG):

Persons Covered- Individual.

Deductions admissible under this Section is:

i. Statutory limit Rs 5000;

ii. Actual rent paid less 10% of 'Adjusted Total Income'.

iii.25% of such 'Adjusted Total Income'. Whichever is less. Adjusted GTI= GTI - (LTCG + STCG on shares covered under STT + income referred to in section 115A+ all other deductions u/s 80except 80GG).

10.3.11 Deduction in respect of contribution given by companies to political parties or electoral trust (80GGB)

Any sum contributed by an Indian Company, other than cash, in the previous year to any political party or to an electoral trust shall be allowed as deduction while computing its total income.

10.3.12 Deduction in respect of contribution given by any person to political parties or electoral trust (80GGC)

Any sum contributed by an assessee, other than cash, in the previous year to any political party or to an electoral trust except local authority and every artificial juridical person wholly or partly funded by the government shall be allowed as deduction while computing its total income.

CHECK THE PROGRESS

One-Word Questions

1. Which section of the Income Tax Act provides deductions for contributions to a pension scheme?
   - **Answer: 80CCC**
2. What is the maximum amount of deduction under Section 80E for interest on an education loan?
   - **Answer: Unlimited**
3. Which section allows tax benefits for donations made to scientific research institutions?
   - **Answer: 80GGA**
4. What is the section number for tax deductions related to interest on home loans?
   - **Answer: 80EE**

5. Which section provides deductions for profits from industrial undertakings in backward areas?
    - **Answer: 80-IC**

10.4 DEDUCTIONS IN RESPECT OF CERTAIN INCOMES

10.4.1 Deduction in respect of profits and gains from industrial undertakings or enterprise engaged in infrastructure development (section 80-IA).

Where gross total income of assessee includes any profits and gains derived by an undertaking or an enterprise from any eligible business, a deduction shall be allowed to stated percentage of profit and gains from such business for stated number of years.

1. Undertaking engaged in providing infrastructure facility (80IA(40(i))

Eligible business: developing, operating and maintaining or developing operating and maintaining infrastructure facility.

Form of organisation: industrial undertaking owned by a company registered in India or by a consortium of such companies.

Rate of deduction: @100% of profits of such eligible business. Commencement of operation: on or after 1-4-1995

Period of deduction: 10 years out of 20 years (out of 15 years in case of ports airport etc)beginning with the year in which undertakings develops such infrastructural facility.

2. Telecommunication services (80IA(4)(ii))

Eligible business: telecommunication services, radio paging, domestic satellite services, network of trunking, broadband network and internet services.

Form of organisation: all enterprises whether corporate or not. Commencement of operation: on or after 1-4-1995 but on or before31-3-2005.

Rate of deduction: 100% of profits and gains from such business for first 5 consecutive AY's out of first 15 years.

3. Industrial Park (80IA(4)(iii))

4. Power Sector (80IA(4)(iv))

Eligible business: generation of power; or generation and distribution of power; or transmission or distribution by laying a network of new transmission; or undertakingsubstantial renovation and modernisation of the existing transmission or distribution lines.
Form of organisation: all enterprises whether corporate or not. Commencement of operation: after 1-4-1993 to 31-3-20017.

Rate of deduction: 100% of profits and gains from such business for any 10 consecutive AY's out of first 15 years beginning from the year in which undertaking starts operation.

5. Undertaking setup for reconstruction or revival of power generating plant (80IA(4)(v))
Eligible business: reconstruction or revival of power generating plant. Form of organisation: Indian Co. Commencement of operation: before 31-3-20017. Rate of deduction: 100% of profits and gains from such business for any 10 consecutive AY's out of first 15 years beginning from the year in which undertaking starts operation.

10.4.2 Deduction in respect of profits and gains from certain industrial undertakings other than infra-structure development undertakings (section 80-IB).

The deduction under section 80-IB is available to an assessee whose gross total income includes profits and gains derived from the following business.
 Eligible Profits:
The deduction is available for the profits and gains of an industrial undertaking, subject to the conditions specified in the section. This applies to businesses involved in:

- Manufacturing or production of goods (excluding infrastructure development activities).
- Certain specified sectors, such as small-scale industries, hotel businesses, and certain types of manufacturing.

 Deductions Available:

- 100% deduction on profits for first 5 years.
- 25% deduction for the next 5 years (6th to 10th year).
- 30% deduction for businesses located in non-metro cities or remote areas during the 6th to 10th year.

- Eligible Undertakings:

The deduction under Section 80-IB is available to industrial undertakings that meet certain conditions. These include:

- Small scale industries.
- Businesses in specified sectors (like manufacturing, hotels, etc.).
- Undertakings engaged in the production of certain goods.
- Undertakings in backward regions or certain districts eligible for special treatment.

- Specific Activities Excluded:
  - This section excludes infrastructure development undertakings (such as those related to roads, bridges, ports, and power plants) from its scope.
  - It also does not apply to the profit earned from speculative activities or businesses that deal primarily in investments, stock market activities, etc.
- Types of Businesses Eligible for Deductions under Section 80-IB:
  - Manufacturing undertakings: Businesses involved in the manufacturing or production of tangible goods. For example, a factory manufacturing clothes, electronics, or other tangible products.
  - Hotels: Profits from the operation of a hotel, resort, or other hospitality industry businesses are eligible for deduction, subject to conditions (e.g., minimum number of rooms).
  - Co-generation of power: If an industrial undertaking is generating power using its own plant or co-generating power, it can claim the benefit.
  - Certain specified industries: The Act has listed a few specific industries eligible for deductions, like mining, steel, and some manufacturing sectors.

10.4.3 Special provision in respect of certain undertakings or enterprises in certain special category states (section 80-IC).

his section provides **tax deductions** for companies and undertakings operating in **special category states** (which are typically states with lower levels of industrial development). These states are eligible for tax relief to promote industrial growth and development in these regions. The benefit under this section is available for both existing as well as new industrial undertakings or enterprises.

Eligibility Criteria:

1. **Location of the Undertaking**:
   - The business must be located in one of the **special category states** as defined by the government. These generally include the **northeastern states** of India (such as Assam, Sikkim, Arunachal Pradesh, Mizoram, Manipur, Nagaland, Tripura, Meghalaya, and other hilly areas).

2. **Nature of Business**:
    - The deduction applies to **manufacturing or production activities**. This typically includes businesses like factories, plants, and units that produce tangible goods.

Tax Deductions Available:

Under Section 80-IC, a **100% deduction** of income is available for the first **5 years** of operation, followed by a **25%** deduction in the subsequent **5 years** (for general category states) or **30%** (for backward areas).

Detailed Breakdown:

1. **First 5 years**: The undertaking or enterprise gets **100% tax deduction** of its profits.
2. **Next 5 years (6th to 10th year)**: The tax benefit reduces:
    - **For general category states**: 25% deduction.
    - **For hilly or backward areas**: 30% deduction.
3. **After 10 years**: The tax benefit under this section ceases.

This section was introduced to boost investment and industrialization in these underdeveloped or underdeveloped regions, with the goal of creating jobs and improving the local economy.

10.4.4 Deduction in respect of employment of new workmen (80JJAA).

Eligible assessee: Indian co.

GTI should include should include profits and gains derived from manufacture of goods in factory.

Amount of deduction: 30% of additional wages paid to new regular workmen employed by the assessee in the previous year for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

Additional wages means the wages paid to new regular workman in excess of 100 workmen employed during the previous year.

However in case of an existing factory additional wages shall be nil if the increase in the number of regular workmen employed during the year is less than 10% of the existing number of workmen employed in such factory as on the last day of the preceding year.

10.4.5 Deduction in respect of royalty income etc., of authors of certain books other than text books (80QQB).

Amount of deduction: the gross total income of assessee pertaining to the previous year includes royalty or the copyright fees, there shall, in accordance with and subject to the provisions of this section, be allowed a deduction of 100% of such income or Rs. 300,000, whichever is less.

10.4.6 Deduction in respect of royalty on patents (80RRB):

(1) Where in the case of an assessee, being an individual, who is –

(a) Resident in India;

(b) A patentee;

(c) In receipt of any income by way of royalty in respect of a patent registered on or after the 1st day of April, 2003 under the Patents Act, 1970, and his gross total income of the previous year includes royalty, there shall, in accordance with and subject to the provisions of this section, be allowed a deduction of 100% of such income or Rs 300,000, whichever is less.

10.4.7 Deduction in respect of interest on deposits in savings account (80TTA):

Eligible assessee: individual or HUF.

Eligible income: interest on deposits in saving accounts with:

a) A banking company to which the Banking Regulation Act, 1949 (10 of 1949), applies (including any bank or banking institution referred to in section 51 of that Act);

(b) A co-operative society engaged in carrying on the business of banking (including a cooperative land mortgage bank or a co-operative land development bank); or

(c) A Post Office as defined in clause (k) of section 2 of the Indian Post Office Act, 1898.

Amount of deduction: actual interest or Rs 10,000 whichever is less.

10.4.8 Deduction in case of a person with disability (80U):

Amount of deduction: In computing the total income of an individual, being a resident, who, at any time during the previous year, is certified by the medical authority to be a person with disability, there shall be allowed a deduction of a sum of Rs 50,000; or a person with severe disability shall be allowed a deduction of a sum of Rs 1,00,000.

CHECK THE PROGRESS

Fill-in-the-Blanks

1. The maximum deduction allowed under Section 80C is _______ per year.
   - **Answer**: ₹1,50,000
2. Section 80D provides deductions for premiums paid on health insurance policies, and the maximum deduction for individuals is _______.
   - **Answer**: ₹25,000
3. Under Section 80E, a deduction is available for the interest on loans taken for _______.
   - **Answer**: Education
4. Deduction under Section 80G for donations to charitable organizations can be claimed only if the donation is made to a _______ organization.
   - **Answer**: Registered
5. Section 80-IC provides deductions for industrial undertakings in _______ (specific states).
   - **Answer**: Special Category States

10.5 LET US SUM UP

The deduction provisions under the Income Tax Act, 1961 offer valuable opportunities for taxpayers to reduce their taxable income and, consequently, their tax liability. By providing incentives for prudent financial planning, savings, and investments, these provisions encourage individuals to secure their financial future while contributing to societal welfare. Deductions under various sections, such as 80C, 80D, 80G, and others, help taxpayers save on taxes by promoting activities like investing in retirement funds, health insurance, education, and charitable donations. These incentives are essential tools for tax planning and allow individuals and businesses to optimize their finances.

However, it is crucial to be aware of the specific conditions, limits, and eligibility criteria for each deduction. Failure to adhere to these rules can result in disallowance of claims or penalties. Taxpayers should maintain proper documentation and stay informed about the latest updates to the tax laws to make the most of these provisions. By effectively utilizing the deductions available under the Income Tax Act, taxpayers not only reduce their tax liability but also contribute to their long-term financial security, health, and societal betterment. Therefore, understanding and strategically applying these deductions are key to efficient tax planning and financial growth.

10.6 KEYWORDS

Deduction (in Income Tax):

A deduction is an amount that a taxpayer is allowed to subtract from their gross total income as per the provisions of the Income Tax Act from **Section 80 C to Section 80 U** before calculating the taxable income. Deductions reduce the overall income on which tax is computed, thereby lowering the tax liability.

In simple terms:

It's a legally permitted reduction from your total earnings, which helps you pay less tax.

Chapter VI-A

A chapter in the Income Tax Act that contains various sections allowing taxpayers to claim deductions from their gross total income to reduce taxable income.

Section 80C

A popular deduction section that allows taxpayers to claim a deduction up to ₹1.5 lakh for investments and payments such as life insurance premiums, PPF, NSC, and tuition fees.

Section 80D

Allows deduction for premiums paid on health insurance policies for self, family, and parents, promoting healthcare coverage.

Tax-saving Investments

Specified investments and expenditures eligible for tax deductions under the Income Tax Act, used as a tool for reducing taxable income.

Eligible Deductions

Allowable amounts under the Income Tax Act that can be deducted from the gross total income to calculate taxable income.

Standard Deduction

A fixed amount that salaried individuals and pensioners can deduct from their income without submitting bills or proofs, simplifying tax computation.

Section 80E

Allows deduction on the interest paid on education loans for higher studies without any maximum limit, but only for 8 consecutive years.

Section 80G

Permits deductions on donations made to specified charitable institutions and funds, encouraging philanthropy.

Limit of Deduction

The maximum amount of deduction that can be claimed under a specific section of the Income Tax Act.

Tax Planning

The strategic arrangement of financial activities to minimize tax liability while complying with legal provisions.

10.7 SELF ASSESSMENT QUESTIONS

1. Explain the deduction given in respect of certain incomes.

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2. Explain the eligibility criteria and limits for claiming deductions under Section 80C.

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3. Explain the deduction given in respect of certain payments.

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10.8 LESSON END EXERCISE

1. What conditions are to be satisfied in order to claim a deduction for donations made to certain funds or/ and charitable institutions? Illustrate.

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2. What are the major types of deductions allowed under Chapter VI-A of the Income Tax Act, and how do they help in reducing taxable income?

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3. Explain in brief the deduction for the medical insurance premium paid by the assessee.

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10.9 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

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UNIT – III **B.COM 4th SEMESTER**

COURSE No. BCG-402 **LESSON No. 11**

COMPUTATION OF TOTAL INCOME OF INDIVIDUAL

STRUCTURE

11.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Define total income and understand its components as per income tax laws.
- Categorize income into the five heads: Salary, House Property, Business, Capital Gains, and Other Sources.
- Calculate taxable income using exemptions, deductions, and allowances.
- Prepare a tax computation sheet based on the calculated total income and applicable tax slabs

Learning outcomes

- Understand the concept of total income and identify the five heads of income.
- Apply income tax rules to compute income under each head.
- Utilize exemptions and deductions to reduce taxable income.
- Prepare an accurate tax computation statement based on total income and tax slabs.

11.1 INTRODUCTION

The computation of total income for an individual is a critical aspect of the income tax system in any country. It involves understanding various types of income and how they are taxed under the relevant provisions of the Income Tax Act. In India, income tax laws classify income into five heads: Salary, House Property, Business or Profession, Capital Gains, and Other Sources. The total income of an individual is calculated by aggregating the income under each of these heads, after considering exemptions, deductions, and other adjustments.

This lesson focuses on the concept of total income, its components, and the tax treatment of income received from different institutions. It explores the impact of residential status on income computation and how income from various sources (both domestic and foreign) is treated differently based on whether the individual is a Resident, Not Ordinarily Resident (NOR), or Non-Resident.

11.2 MEANING OF INDIVIDUAL

An individual means a woman, man, minor child or any human being. An individual has to pay income tax on his total income at a graded scale of tax rates ruling during the concerned assessment year. In addition to his own income under different heads, an individual may also get a share of income from his membership in the following institutions and some incomes of others are also to be included in his total income.

CHECK THE PROGRESS

True or False:

1. Income tax in India is charged on the total income of the previous year.

   Answer: True
2. A person can claim both HRA exemption and deduction on home loan interest.

   Answer: True
3. Clubbing provisions apply to income earned by major children.

   Answer: False
4. Loss under "Income from House Property" can be set off against salary income.

   Answer: True
5. Gifts received from relatives are always taxable.

   Answer: False

11.3 TAX TREATMENT OF INCOME RECEIVED FROM DIFFERENT INSTITUTIONS

1. **Income Received as a Member of HUF (Hindu Undivided Family)**
   - Exempt under Section 10(2): The income received by an individual as a member of an HUF is generally exempt from tax. However, if an individual transfers his personal property into the common pool of the HUF, the income derived from such property shall be included in the individual's total income (i.e., the income from converted property will be taxed in the hands of the individual, not the HUF).
2. **Income Received as Share from AOP (Association of Persons)**
   - Taxability of Share from AOP:
     - If the income of all partners in the AOP does not exceed the basic exemption limit (i.e., the first income slab), the share of income from the AOP is fully exempt from tax.
     - If the income of any partner exceeds the basic exemption limit, then the share of income from the AOP is included in the individual's taxable income.
3. **Income Received as a Partner of a Firm Assessed under Section 184**
   - Exempt under Section 10(2A): A partner's share of profit from a firm that is assessed as a firm under Section 184 is exempt from tax in the hands of the partner. However, any remuneration or interest on capital received from the firm is taxable under the head "Profits and Gains of Business or Profession" to the extent it is allowed as a deduction to the firm.
4. **Income Received as a Partner of a Firm Assessed under Section 185**
   - Exempt under Section 10(2A): A partner's share of profit from a firm that is assessed as a firm under Section 185 (i.e., a non-partnership firm or a firm not required to maintain books of accounts) is exempt.
   - Any remuneration or interest on capital received from such a firm is also exempt from tax.
5. **Income Received as a Shareholder of a Company**
   - Exempt under Section 10(34): The dividend income received by an individual from a domestic company is exempt from tax under Section 10(34), provided that the dividend is not more than ₹10 lakh (as per current laws).
   - Tax on Dividend: However, dividends exceeding ₹10 lakh are subject to tax in the hands of the shareholder under the new Taxation of Dividend provisions.

11.4 INCOME OF OTHER PERSONS TO BE INCLUDED IN THE TOTAL INCOME OF AN INDIVIDUAL

The following incomes although accruing to other persons are included in the income of individual assessee:

1. Transfer of an income without transfer of asset.
2. Revocable transfer of asset.
3. Income of minor child.
4. Income from asset transferred to spouse, daughter in law by an individual without adequate consideration shall be included in the income of that individual.
5. Income from the asset transferred by an individual in such a way that benefit accrues directly to him.

CHECK THE PROGRESS

Fill in the Blanks:

1. Income from ________ property is taxed under the head "Income from House Property".
   Answer: house
2. The maximum deduction allowed under Section 80C is ₹________.
   Answer: ₹1,50,000
3. Salary received from more than one employer is ________ in computing total income.
   Answer: aggregated
4. The ________ method of accounting is generally followed for income from salary.
   Answer: accrual
5. Agricultural income is ________ from income tax under Section 10(1).
   Answer: exempt

11.5 COMPUTATION OF GROSS TOTAL INCOME

The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

Deductions from Gross Total Income:

There are deductions prescribed from gross total income. The allowable deductions in case of an individual are deductions under sections 80C, 80CCC, 80CCD, 80CCF, 80D, 80DD, 80DDB, 80E, 80G, 80GG,

80GGA, 80GGC, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID,80-IE, 80JJA, 80QQB, 80RRB, 80TTA and 80U. These deductions are allowed as per the rules prescribed in the income-tax act.

11.6 PRATICAL PROBLEM

ILLUSTRATION

Compute the total income of Mr. Ram from the particulars given below:

	Rs.
i) Interest on securities	27000
ii) Rental Value of a house Rs 7500 p.m. self-acquired but transferred to HUF Pool. Computed income from this house is	25200
iii) Share from firm assessed u/s 184in which he has 1/3rd share	45000
iv) Commission received by his wife from above mentioned firm for acting as its selling agent	25000

SOLUTION:

Computation of Total Income of Mr. Ram	**Rs.**	**Rs.**
Profits and Gains		
1/3rd Share from the firm assessed u/s 184 (Exempted)	Nil	
Other Sources:		
a) Commission received by wife from a firm in which spouse has substantial interest u/s 64(1)(ii)	25000	
b) Income from self- acquired asset converted into common pool of HUF u/s 64(2)	25200	
c) Interest on Securities	27000	
Total Income		77200

ILLUSTRATION II

For the accounting year ended 31st, March 2021 Mr. Shashi Kant furnishes the following particulars of his Income.

	Rs.
i) Salary received in India	60000
ii) Profit from business in Germany but received in India15000	

iii) Income from house property in Pakistan deposited in bank there 12000

iv) Profit from business established in Bangladesh but business is controlled from India46000

v) Income accrued in India but received in Sweden 25000

vi) In this accounting year Mr. Shashi Kant has brought into India foreign income of earlier years 42700

vii) Profit from sale of plant at Mumbai (50% received in Bangkok) 160000

viii) Interest on japan development bonds (60% received in India) 100000

compute his total Income if

a) He is resident,

b) He is not ordinarily resident, or

c) He is non-resident.

SOLUTION

Total Income Calculation:

Particulars	**Resident**	**Not Ordinarily Resident**	**Non-Resident**
Salary	₹60,000	₹60,000	₹60,000
Income from India (accrued in Sweden)	₹25,000	₹25,000	₹25,000
Profit from Sale of Plant (Mumbai)	₹1,60,000	₹1,60,000	₹1,60,000
Profit from Business (Germany)	₹15,000	₹15,000	₹15,000
Interest on Japan Development Bonds	₹60,000	₹60,000	₹60,000
Income from House Property (Pakistan)	₹0	₹0	₹0
Foreign Income Brought into India (Earlier Years)	₹0	₹42,700	₹0
Total Income	**₹4,20,000**	**₹3,62,700**	**₹3,20,000**

CHECK THE PROGRESS

Multiple Choice Questions (MCQs):

1. Which of the following is not a head of income under the Income Tax Act?

   a) Income from Salary

   b) Income from Business or Profession

   c) Income from Agriculture

   d) Capital Gains

Answer: c) Income from Agriculture

2. Exempt income is:

   a) Fully taxable

   b) Partially taxable

   c) Not included in total income

   d) Always taxed at a flat rate

   Answer: c) Not included in total income

3. The basic exemption limit for an individual below 60 years under the old regime (as of AY 2024-25) is:

   a) ₹2,50,000

   b) ₹3,00,000

   c) ₹5,00,000

   d) ₹1,50,000

   Answer: a) ₹2,50,000

4. Under which section can a deduction be claimed for investment in PPF, LIC, etc.?

   a) Section 80C

   b) Section 10

   c) Section 24

   d) Section 44ADA

   Answer: a) Section 80C

5. Which of the following is taxable under the head "Income from Other Sources"?

   a) House Rent

   b) Salary

   c) Lottery Winnings

   d) Professional Fees

   Answer: c) Lottery Winnings

11.7 LET US SUM UP

Computing the total income of an individual requires an understanding of the classification of income and the applicable provisions of the Income Tax Act. By carefully analyzing each type of income, applying exemptions, deductions, and considering the residential status, one can accurately determine the total taxable income. The practical problems presented in this lesson illustrate how to handle various scenarios, including income from foreign sources, business profits, and income received from other institutions.

By mastering the process of income classification, exemption application, and taxable income calculation, individuals can ensure compliance with tax laws while minimizing their tax liability. The importance of understanding the residential status of the individual cannot be overstated, as it directly influences the taxability of foreign income and other adjustments.

This knowledge will enable students and professionals to compute the total income for any individual, preparing them for real-world tax filings and efficient financial planning.

11.8 KEYWORDS

Total Income

The sum of all income earned by an individual during a financial year from various sources (e.g., salary, business, house property, etc.) after considering exemptions, deductions, and adjustments. Total income is used to determine the amount of tax liability.

Residential Status

An individual's status (Resident, Not Ordinarily Resident, or Non-Resident) determines the taxability of their income. It affects whether income earned in India and abroad will be taxed in India. The residential status is key to computing an individual's total income, especially for those earning foreign income.

Heads of Income

The five categories under which all income is classified for tax purposes: Salary, House Property, Business or Profession, Capital Gains, and Other Sources. Each head has specific rules for calculation and taxation.

Exemptions

- **Meaning:** Certain incomes or portions of income that are legally excluded from taxation under the Income Tax Act (e.g., agricultural income, certain types of dividends). Exemptions reduce the total taxable income.

Deductions

Specific expenses or investments that can be subtracted from the gross total income to arrive at the taxable income. Examples include deductions under Section 80C (investments like PPF, life insurance premiums) and Section 80D (health insurance premiums).

11.9 SELF ASSESSMENT QUESTIONS

1. List the five heads of income under the Income Tax Act and give one example of each.

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2. How does the income of a partner from a firm assessed under Section 184 get taxed?

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3. Explain the tax treatment of income received from different institutions.

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11.10 LESSON END EXERCISE

1. Discuss the concept of Individual assessee?

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2. List the steps to be followed while computing Total income of the assessee?

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3. List the Income of other persons to be included in the total income of an individual**?**

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11.11 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

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6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati

Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

COMPUTATION OF TAX LIABILITY OF INDIVIDUAL

STRUCTURE

12.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand the process of determining the residential status of an individual for income tax purposes.
- Classify income correctly under the five heads specified in the Income-tax Act, 1961.
- Learn how to compute total income and tax liability under both the Old and New Tax Regimes.
- Apply deductions, exemptions, rebates, and special rates for different types of income such as capital gains, casual income, etc.

Learning outcomes

- Accurately calculate an individual's total income and tax payable for a given financial year.
- Differentiate between the old and new tax regimes and choose the more beneficial option.
- Apply relevant tax rates, surcharges, and cess to arrive at final tax liability.
- Interpret practical case studies and compute tax liability using real-life income and deduction scenarios.

12.1 INTRODUCTION

Taxation is a crucial aspect of financial planning for every individual. The Indian Income-tax Act, 1961, lays down a comprehensive framework for determining the tax liability of individuals based on their income, residential status, and various applicable provisions. The computation of tax liability involves a systematic assessment of income earned under different heads, adjusting for exemptions, deductions, and applicable tax rates.

With the introduction of the New Tax Regime (Section 115BAC), taxpayers now have an option to choose between the Old Regime, which offers various deductions and exemptions, and the New Regime, which features lower slab rates but restricts most deductions. The selection between these regimes requires careful consideration of income structure and eligible deductions to minimize tax liability.

This chapter aims to equip learners with a clear understanding of how to compute an individual's total income and the corresponding tax liability under both regimes. It covers detailed steps involved in determining total income, tax computation, and the final payable tax, supported with practical illustrations to enhance conceptual clarity.

12.2 ASSESSMENT OF INDIVIDUALS

Individual includes both male and female assessees. The total income has to be computed as per the provisions of the Income-tax Act, 1961. In addition to individuals own income, income of other persons received by him in some other capacity or received by other persons is to be clubbed with individual assesses income. Following steps are considered for computing total income and to charge tax.

Step 1 – Determination of the residential status of the Assessee: First all we want determine the residential status of the assessee. The residential status of a person has to be determined to find out which income is to be included in computing the total income. It decides whether the individual is tobe taxed or not. The residential status of an individual is determined on the basis of the duration of time spend by him in India. . Based on the time spent by him, he may be (a) resident and ordinarily resident,

(b) resident but not ordinarily resident, or (c) non-resident.

Step 2 – Classification of income under different heads: The Act specifies five heads of income. These heads of income consist of all possible types of income that can accrue to or be received by an individual. An individual is required to classify the income earned by him under the appropriate heads of income.

Step 3 – Exclusion of income not chargeable to tax: There are certain incomes which are wholly exempt from income-tax e.g. agricultural income. These incomes have to be excluded while calculating Gross Total

Income. T the same time certain incomes are partially exempt from income tax e.g. House Rent Allowance, Education Allowance etc.. These incomes are excluded only to the extent of the limits specified in the Act. The balance income over and above the prescribed limits would enter computation of total income and have to be classified under the relevant head of income.

Step 4 – Computation of income under each head: Income is to be computed in accordance with the provisions governing a particular head of income. As per the rules certain deductions and allowances are allowed. These deductions are allowed while computing income under each head.

Step 5 – Clubbing of income of spouse, minor child etc.: In case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive. That means if income increases the tax amount to be paid also increases. We can see that some taxpayers who have the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been included in the Income-tax Act. As per the provisions of income tax act income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person when it is seen that the income is diverted for avoiding tax.

Step 6 – Set-off or carry forward and set-off of losses: An individual may have different sources of income under the same head of income. He might have profit from one source and loss from the other. As per the provision we can set off the losses under one head or form other heads or can carry forwards for the coming assessment years. All provisions related to that should be considered while computing total income of the Assessee.

Step 7 – Computation of Gross Total Income: The final figures of income or loss under each head of income, after allowing the deductions, allowances and other adjustments, are then aggregated, after giving effect to the provisions for clubbing of income and set-off and carry forward of losses, to arrive at the gross total income.

Step 8 – Deductions from Gross Total Income: There are deductions prescribed from gross total income. The allowable deductions in case of an individual are deductions under sections 80C, 80CCC, 80CCD, 80CCF, 80D, 80DD, 80DDB, 80E, 80G, 80GG, 80GGA, 80GGC, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE, 80JJA, 80QQB, 80RRB, 80TTA and 80U. These deductions are allowed as per the rules prescribed in the income tax act.

Step 9 – Compute Total income: After allowing all deductions allowable, we can compute total income.

Step 10 – Application of the rates of tax on the total income: Different slab of tax rates are available on basis of status and age of individual. There also will be basic exemption limit.

CHECK THE PROGRESS

MCQs

1. Which tax regime allows taxpayers to claim deductions and exemptions?

   a) Old Regime

   b) New Regime

   c) Both

   d) None

2. Under the New Regime, taxpayers:

   a) Pay higher tax rates with exemptions

   b) Pay lower tax rates but cannot claim most deductions

   c) Can claim all exemptions as in Old Regime

   d) Are exempt from paying income tax

Answers

1. a) Old Regime
2. b) Pay lower tax rates but cannot claim most deductions

12.3 COMPUTATION OF TAX LIABILITY

After computing the total income, next step is to compute the tax liability. The following steps are to be followed:

1. Round Off Total Income

Round off your total income to the nearest multiple of ₹10.

2. Divide Total Income into Components

Break down your total income into the following categories:

- Long-Term Capital Gains (LTCG): Taxed at 20%.
- Short-Term Capital Gains (STCG) on shares subject to Securities Transaction Tax (STT): Taxed at 15%.
- Casual Income: Taxed at 30%.
- Balance Income: Remaining income after subtracting the above components.

3. Apply Tax Slabs (New Regime)

Under the new tax regime, the income tax slabs for individuals are as follows:

Income Range (₹)	Tax Rate
Up to 4,00,000	Nil
4,00,001 to 8,00,000	5%
8,00,001 to 12,00,000	10%
12,00,001 to 16,00,000	15%
16,00,001 to 20,00,000	20%
20,00,001 to 24,00,000	25%
Above 24,00,000	30%

Note: The new tax regime is now the default tax system, but taxpayers can opt for the old tax regime if they find it more beneficial.

4. Rebate Under Section 87A

For the new tax regime, a rebate of ₹60,000 is available for individuals with taxable income up to ₹12,00,000. This effectively results in zero tax liability for such individuals.

5. Surcharge

Surcharge is applicable if the total income exceeds ₹50 lakh. The rates are as follows:

Total Income (₹)	Surcharge Rate
Above 50,00,000	10%
Above 1,00,00,000	15%
Above 2,00,00,000	25%
Above 5,00,00,000	37%

6. Health and Education Cess

An additional Health and Education Cess of 4% is levied on the income tax payable, including surcharge, if applicable.

7. Final Tax Payable

After applying the above steps, the final tax payable is determined. This amount is then rounded off to the nearest multiple of ₹10.

Example Calculation:

Let's assume the following:

- Total Income: ₹15,00,000
- LTCG: ₹2,00,000
- STCG on shares subject to STT: ₹1,00,000
- Casual Income: ₹50,000

Steps:

1. Round off Total Income: ₹15,00,000 (already a multiple of ₹10).
2. Divide Total Income:
    - LTCG: ₹2,00,000 × 20% = ₹40,000
    - STCG on shares subject to STT: ₹1,00,000 × 15% = ₹15,000
    - Casual Income: ₹50,000 × 30% = ₹15,000
    - Balance Income: ₹15,00,000 - ₹2,00,000 - ₹1,00,000 - ₹50,000 = ₹11,50,000
3. Apply Tax Slabs:
    - Up to ₹4,00,000: Nil
    - ₹4,00,001 to ₹8,00,000: ₹4,00,000 × 5% = ₹20,000
    - ₹8,00,001 to ₹11,50,000: ₹3,50,000 × 10% = ₹35,000
    - Total Tax on Balance Income: ₹20,000 + ₹35,000 = ₹55,000
4. Add Taxes on Special Components:
    - LTCG Tax: ₹40,000
    - STCG Tax: ₹15,000
    - Casual Income Tax: ₹15,000
    - Total Tax on Special Components: ₹40,000 + ₹15,000 + ₹15,000 = ₹70,000
5. Total Tax Before Rebate: ₹55,000 + ₹70,000 = ₹1,25,000
6. Apply Rebate Under Section 87A: ₹60,000 (since total income is below ₹12,00,000)
7. Net Tax Payable: ₹1,25,000 - ₹60,000 = ₹65,000
8. Add Health and Education Cess: ₹65,000 × 4% = ₹2,600
9. Final Tax Payable: ₹65,000 + ₹2,600 = ₹67,600

Rounded Off Final Tax Payable: ₹67,600 (already a multiple of ₹10)

12. 4 SLAB RATES UNDER NEW AND OLD REGIME

The slab rates are different under the new and old regimes. Under the old regime, the rates vary based on age: individuals under 60, those between 60 and 80, and those over 80. Under the new regime, the tax slabs are the same for all age groups.

The tax slabs under the old regime are as follows:

Slabs (Rs.)	**Individuals (Age < 60 years)**	**Resident Senior Citizens (>60 but <80 years)**	**Resident Super Senior Citizens (80 years and above)**
Upto 2,50,000	Nil	Nil	Nil
2,50,001 - 3,00,000	5%	Nil	Nil
3,00,001 - 5,00,000	5%	5%	Nil
5,00,000 - 10,00,000	20%	20%	20%
Above 10,00,000	30%	30%	30%

The tax slabs under the new regime is as follows:

Tax Slab for FY 2024-25	**Tax Rate**
Upto 3,00,000	Nil
3,00,001 - 7,00,000	5%
7,00,001 - 10,00,000	10%
10,00,001 - 12,00,000	15%
12,00,001 - 15,00,000	20%
Above 15,00,000	30%

Surcharge and Education Cess:

If your income exceeds a certain threshold, you will incur additional taxes on top of the existing rates. This additional tax specifically targets high-income earners.

The surcharge rates are as follows:

- 10% of Income tax if total income > Rs.50 lakh and < Rs.1 crore,

- 15% of Income tax if total income > Rs.1 crore and < Rs.2 crore,
- 25% of Income tax if total income > Rs.2 crore and < Rs.5 crore,
- 37% of Income tax if total income > Rs.5 crore

Note: The highest surcharge rate of 37% has been reduced to 25% under the new tax regime.

Additional Health and Education cess at the rate of 4% will be added to the income tax liability.

Note: There are certain deductions/exemptions which are not available under the New regime.

CHECK THE PROGRESS

True/False

1.The Old Regime has lower tax rates than the New Regime. (True/False)

2.The New Regime does not allow deductions like Section 80C investments. (True/False)

Answers

1. False

2. True

12.5 PRACTICAL PROBLEMS

ILLUSTRATION

Mr. Verma is the manager of Punjab Cotton Mills Ltd. He draws a salary of Rs. 30000 p.m. His other items of income are:

a) Interest on fixed deposits with Andhra Bank Rs. 10800 and interest credited in the savings a/c in the bank Rs. 12000.

b) Winning from Lottery Rs. 60000.

c) Dividend from an Indian Company Rs. 3600.

d) Long term capital gains from sale of his residential house, occupied for the last 20 years Rs. 115000.

e) Short Term capital lossRs. 10000.

f) Long term capital loss from Gold brought forward from the assessment year 2015-16 Rs. 20000.

The following deductions are claimed:

i) Life Insurance premium(policy for 100000 taken 2005) Rs. 14500.

ii) Donation for Punjabi University Rs. 5000.

iii) *Donation to clean Ganga fund setup by Central Govt. Rs. 5000.*

iv) *Education of his children Rs. 4500.*

Compute his total income and Tax payable for the assessment year 2025-26

SOLUTION

Under the Old Tax Regime (since deductions are claimed):

 Computation of Total Income

1**. Income from Salary**

Particulars	Amount (₹)
Gross Salary (₹30,000 × 12)	3,60,000
Less: Standard Deduction u/s 16(ia)	(50,000)
Net Salary Income	3,10,000

2. **Income from Capital Gains**

Particulars	Amount (₹)
LTCG on sale of residential house	1,15,000
Less: Exemption u/s 54 (Reinvestment in house)	(1,05,000)
Net LTCG	10,000
Less: STCL (set-off in same year)	(10,000)
Net Capital Gain	NIL
Note: LTCL of ₹20,000 (AY 2015–16) cannot be carried forward	-

3. **Income from Other Sources**

Particulars	Amount (₹)
Interest on Fixed Deposit	10,800
Interest on Savings Account	12,000
Winnings from Lottery (taxed @30%)	60,000
Dividend from Indian Company (Exempt)	Nil
Total Income from Other Sources	82,800

4. Gross Total Income

Source	Amount (₹)
Income from Salary	3,10,000
Income from Capital Gains	NIL
Income from Other Sources	82,800
Gross Total Income	3,92,800

5. Deductions Under Chapter VI-A

Section	Particulars	Amount (₹)
80C	Life Insurance Premium	14,500
80G	Donation to Punjabi University (100%)	5,000
	Donation to Clean Ganga Fund (100%)	5,000
80TTA	Interest on Savings (max ₹10,000 allowed)	10,000
Total Deductions	34,500	

Net Taxable Income

Particulars	Amount (₹)
Gross Total Income	3,92,800
Less: Deductions	(34,500)
Net Taxable Income	3,58,300

Computation of Tax Liability

A. Tax on Normal Income (₹2,98,300 after removing lottery winnings)

Slab	Amount (₹)	Rate	Tax (₹)
Up to ₹2,50,000	2,50,000	Nil	0
₹2,50,001 – ₹2,98,300	48,300	5%	2,415
Total Tax (Normal Income)			2,415
Less: Rebate u/s 87A (income < ₹5L)			(2,415)
Tax on Normal Income (after rebate)			0

B. Tax on Lottery Income (Flat Rate)

Income Type	Amount (₹)	Rate	Tax (₹)
Lottery Winnings	60,000	30%	18,000
Tax on Lottery			18,000

C. Health & Education Cess

Particulars	Rate	Amount (₹)
On ₹18,000 (only lottery taxed)	4%	720

Total Tax Payable		18,720

✅Final Summary

Description	Amount (₹)
Total Income	3,58,300
Total Tax Payable	18,720
Rounded Off	₹18,720

SOLUTION

Under the New Tax Regime for Mr. Verma for Assessment Year 2025–26

Under the New Tax Regime:

- Most deductions (like 80C, 80G, 80TTA) are not allowed
- Standard deduction of ₹50,000 is allowed for salaried employees (as per Budget 2023)

Computation of Total Income – New Regime

1. Income from Salary

Particulars	Amount (₹)
Gross Salary (₹30,000 × 12)	3,60,000
Less: Standard Deduction u/s 16(ia)	(50,000)
Net Salary Income	3,10,000

2. Income from Capital Gains

Particulars	Amount (₹)
LTCG on sale of house	1,15,000
Less: Exemption u/s 54 (reinvestment)	(1,05,000)
Net LTCG	10,000
Less: STCL (set-off in same year)	(10,000)
Net Capital Gains	Nil
LTCL from AY 2015–16 not eligible (more than 8 years)	**-**

3. Income from Other Sources

Particulars	Amount (₹)
Interest on Fixed Deposits	10,800
Interest on Savings Account	12,000
Winnings from Lottery	60,000
Dividend from Indian Company	Exempt

Total	82,800

4. Gross Total Income

Source	Amount (₹)
Income from Salary	3,10,000
Capital Gains	NIL
Other Sources	82,800
Gross Total Income	3,92,800

5. Deductions (New Tax Regime)

Section	Description	Amount (₹)
80C	Not allowed	-
80G	Not allowed	-
80TTA	Not allowed	-
Total		0

Net Taxable Income

Particulars	Amount (₹)
Gross Total Income	3,92,800
Less: Deductions	0
Taxable Income	3,92,800

□ **Computation of Tax Liability (New Regime)**

A. Tax on Normal Income (₹3,32,800 excluding lottery)

Slab (New Regime – AY 2025–26)	Amount Taxed (₹)	Rate	Tax (₹)
Up to ₹3,00,000	3,00,000	Nil	0
₹3,00,001 to ₹3,92,800	92,800	5%	4,640
Total Tax on Normal Income			4,640
Less: Rebate u/s 87A (if TI ≤ ₹7L)	-		(4,640)
Tax on Normal Income			0

B. Tax on Lottery Income (Special Rate)

Particulars	Amount (₹)	Rate	Tax (₹)
Lottery Winnings	60,000	30%	18,000
Tax on Lottery			18,000

C. Health & Education Cess

Particulars	Rate	Amount (₹)
On Lottery Income Tax (₹18,000)	4%	720
Total Cess		720

Final Summary – New Regime

Description	Amount (₹)
Total Income	3,92,800
Total Tax (on Lottery)	18,000
Add: Cess @4%	720
Total Tax Payable	18,720
Rounded Off	₹18,720

Conclusion:

- Tax Payable (Old Regime): ₹18,720
- Tax Payable (New Regime): ₹18,720

  Same in this case, because rebate u/s 87A applies in both, and deductions in old regime are mostly neutralized by the rebate.

ILLUSTRATION

Mr. Raj is a resident individual (age 35). He has the following income and investments for the FY 2024–25:

Income & Deductions	Amount (₹)
Salary (₹75,000 per month)	9,00,000
Interest from savings bank account	15,000
Interest from fixed deposits	20,000
Rent received from house property	2,40,000
Municipal taxes paid	40,000
Interest on home loan (self-occupied property)	1,80,000
Life Insurance Premium (for self and family)	60,000
Contribution to PPF	50,000
Tuition Fees for children (2 kids @ ₹25,000 each)	50,000
Donation to PM CARES Fund	20,000

Compute his tax liability under both Old and New Tax Regimes for AY 2025–26, and compare the results.

SOLUTION

1. Income Computation (Same for Both Regimes)

A. Income from Salary

Particulars	Amount (₹)
Gross Salary	9,00,000
Standard Deduction	(50,000)
Taxable Salary	8,50,000

B. Income from House Property

Particulars	Amount (₹)
Rent Received	2,40,000
Less: Municipal Taxes	(40,000)
Net Annual Value (NAV)	2,00,000
Less: Standard Deduction @30%	(60,000)
Less: Interest on Home Loan	(1,80,000)
Income from House Property	(40,000) (Loss)

Note: In New Regime, set-off for home loan interest (on self-occupied property) is not allowed.

C. Income from Other Sources

Particulars	Amount (₹)
Interest on Savings Account	15,000
Interest on Fixed Deposits	20,000
Total	35,000

2. Total Income Before Deductions

Source	Old Regime (₹)	New Regime (₹)
Income from Salary	8,50,000	8,50,000
Income from House Property	(40,000)	0 (Not allowed)
Other Sources	35,000	35,000
Gross Total Income	8,45,000	8,85,000

3. Deductions (Only for Old Regime)

Section	Particulars	Amount (₹)
80C	LIC (60K) + PPF (50K) + Tuition (50K)	1,50,000
80G	Donation to PM CARES Fund (100% eligible)	20,000
80TTA	Savings Interest (max ₹10,000)	10,000
Total Deductions		1,80,000

4. Taxable Income

Regime	Taxable Income (₹)
Old Regime	6,65,000
New Regime	8,85,000

5.Tax Liability Calculation

Old Tax Regime

Slab	Tax Rate	Amount (₹)
Up to ₹2,50,000	Nil	0
₹2,50,001 – ₹5,00,000	5%	12,500
₹5,00,001 – ₹6,65,000	20%	33,000
Total Tax		45,500
Less: Rebate u/s 87A	❌Not eligible	-
Add: Health & Education Cess @4%		1,820
Total Tax Payable		₹47,320

New Tax Regime (as per AY 2025–26 slabs)

Slab	**Tax Rate**	**Amount (₹)**
Up to ₹3,00,000	Nil	0
₹3,00,001 – ₹6,00,000	5%	15,000
₹6,00,001 – ₹9,00,000	10%	28,500
Total Tax		43,500
Less: Rebate u/s 87A (TI > 7L)	❌Not eligible	-

Add: Health & Education Cess @4%		1,740
Total Tax Payable		₹45,240

6. Comparison Table

Particulars	Old Regime	New Regime
Gross Total Income	₹8,45,000	₹8,85,000
Total Deductions	₹1,80,000	₹0
Taxable Income	₹6,65,000	₹8,85,000
Total Tax (before cess)	₹45,500	₹43,500
Add: Health & Edu. Cess @ 4%	₹1,820	₹1,740
Total Tax Payable	₹47,320	₹45,240
Difference in Tax	→ ₹2,080 more	✅₹2,080 less

Conclusion

Mr. Raj pays ₹2,080 less under the New Regime because his deductions (though substantial) are not enough to outweigh the lower slab rates of the New Regime.

12.6 LET US SUM UP

The computation of an individual's tax liability is not merely a statutory requirement but also a vital component of effective financial planning. As detailed in this chapter, calculating tax liability involves multiple steps—from determining residential status and categorizing income under various heads, to claiming eligible deductions and applying the correct tax slabs.

The advent of the New Tax Regime has added a significant dimension to tax planning. Through comparative illustrations, we observe that while the Old Regime benefits those with substantial deductions and exemptions, the New Regime is advantageous for individuals with fewer deductions due to its concessional rates.

Ultimately, the choice between the old and new tax regimes should be driven by a careful evaluation of one's income profile and available deductions. A sound understanding of tax computation principles enables individuals to make informed decisions, ensuring tax efficiency and compliance with the law.

CHECK THE PROGRESS

Fill in the blanks

- The **basic exemption limit** for individuals below 60 years in AY 2025–26 is ₹__________.

➢**Answer:** ₹2,50,000

- **Long-term capital gains** are generally taxed at the rate of _______%.

➢**Answer:** 20%

- **Section 87A** provides a rebate to resident individuals with income up to ₹__________ under the new regime.

➢**Answer:** ₹7,00,000

- The **Health and Education Cess** is levied at _______% on the income tax payable.

➢**Answer:** 4%

- Casual income like lottery winnings is taxed at a flat rate of _______%.

➢**Answer:** 30%

12.7 KEYWORDS

Old Regime

The Old Regime refers to the existing income tax system where taxpayers can claim various deductions and exemptions (like House Rent Allowance, Section 80C investments, etc.) to reduce their taxable income. The tax slabs under this regime are relatively higher, but taxpayers get the benefit of multiple tax-saving options.

New Regime

The New Regime is an alternative income tax system introduced with lower tax slab rates but without most of the deductions and exemptions available under the Old Regime. Taxpayers opting for this regime pay tax at lower rates but have to forgo most tax deductions.

Residential Status

The classification of an individual based on the duration of stay in a country during a financial year, which determines the scope of taxable income in that country.

Gross Total Income

The total income computed under various heads (like salary, house property, business, capital gains, and other sources) before any deductions are applied.

Deductions

Allowable expenses or investments that reduce the gross total income to arrive at the taxable income, as specified under sections of the Income Tax Act.

Taxable Income

The income amount on which tax is calculated after subtracting deductions and exemptions from the gross total income.

Tax Deducted at Source (TDS)

A mechanism where tax is collected at the time the income is generated or paid, by deducting a certain percentage before the recipient receives the amount.

12.8 SELF ASSESSMENT QUESTIONS

1. Name deduction allowed under the Old Regime but not under the New Regime.

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....

2. What is meant by 'Gross Total Income' in income tax?

....

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....

3. Can a taxpayer switch between Old and New Regimes every financial year? Explain briefly.

....

....

....

12.9 LESSON END EXERCISE

1. Name any two types of income that are fully exempt from income tax.

....

....

....

2. Define the Old Regime in the context of income tax.

....

....

....

3. Which regime would suit someone who does not invest in tax-saving instruments and why?

....

....

....

12.10 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

REBATE AND RELIEF OF TAX

STRUCTURE

13.0 Learning Objectives and Learning Outcomes

13.1 Introduction

13.2 Rebate of Tax

13.2.1 What is Rebate u/s 87A?

13.2.2 Eligibility Criteria for Rebate

13.2.3 How Much is the Rebate Allowed u/s 87A?

13.2.4 Steps to Claim a Tax Rebate Under Section 87A

13.2.5 Rebate Against Various Tax Liabilities

13.2.6 Rebate Limit Under Section 87A for the Different Financial Years

13.3 Relief of Tax

13.3.1 Relief under Section 89(1)

13.3.2 How to Calculate Tax Relief under Section 89(1) on Salary Arrears?

13.3.3 Filing Form 10E

13.4 Let Us Sum Up

13.5 Keywords

13.6 Self Assessment Questions

13.7 Lesson End Exercise

13.8 Suggested Readings

13.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Define *rebate* and *relief* in simple terms.
- Identify different kinds of tax rebates and reliefs.
- Apply rebates and reliefs in basic tax calculations.
- Recognize the eligibility requirements to claim them

Learning outcomes

- Understand what *rebate* and *relief* mean in taxes.
- Know the types of tax rebates and reliefs available.
- Understand who is eligible and the rules for claiming them.

13.1 INTRODUCTION

Rebate is a tax reduction available to resident individuals when they earn income within a certain ceiling limit. Section 87A provides tax relief to resident individuals falling under lower income brackets. For FY 2024-25, Rs. 25,000 rebate is allowed for income within 7 lakhs under the new regime and Rs. 12,500 is allowed for income within 5 lakhs under the old regime. For FY 2025-26, rebate of Rs. 60,000 is allowed under the new regime for an income up to Rs. 12 lakhs.

The rebate limit for FY 2025-26 (effective from 1st April 2025) has been increased from Rs. 25,000 to Rs. 60,000. As a result, the marginal relief, which was earlier applicable to income slightly above Rs. 7,00,000, will now be available for income exceeding just over Rs. 12,00,000.

In a situation where your total income includes any past dues paid in the current year, you may be worried about paying a higher tax on such arrears.

In such a situation, section 89(1) can come to your rescue which is known as relief of tax.

13.2 REBATE OF TAX

13.2. 1 What is Rebate u/s 87A?

- Generally, tax rebate can be considered as a tax reduction or rather a tax credit available to resident individuals when they fall under lower income groups.
- The rebate can be applied to the total tax before adding a health and education cess of 4%
- Applying rebate can make your tax liability to zero.

13.2.2 Eligibility Criteria for Rebate

- Only resident individuals are eligible to avail rebate under this section.
- Rebate under Section 87A is available to taxpayers whose income does not exceed:
    - Rs. 7 lakh under the new tax regime and
    - Rs. 5 lakh under the old regime.
- The amount of rebate will be lower than the limit specified under Section 87A or total income tax

payable (before cess).

- Rebate under Section 87A cannot be adjusted against tax on long-term capital gains under section 112A.
- From FY 2025-26 Rebate will not be applicable on special rates under income tax.

13.2.3 How Much is the Rebate Allowed u/s 87A?

New Regime

- For FY 2024-25, if an individual's total taxable income is up to Rs.7 lakh, he will be eligible for rebate up to Rs.25,000.
- However, for FY 2025-26, if an individual's total taxable income is up to Rs.12 lakh, he will be eligible for rebate up to Rs.60,000.
- But the rebate allowed shall not exceed the total tax payable before cess in any case.

Old Regime

- A resident individual is having a total taxable income of less than Rs 5 Lakh, up to Rs. 12,500 rebate can be availed.
- But the rebate allowed shall not exceed the total tax payable before cess in any case.

13.2.4 Steps to Claim a Tax Rebate Under Section 87A

Step 1: Calculate your gross total income for the financial year

Step 2: Reduce your tax deductions for tax savings, investments, etc.

Step 3: Arrive at your total taxable income after reducing the tax deductions.

Step 4: Declare your gross income and tax deductions in ITR.

Step 5: Claim a tax rebate under section 87A if your total income does not exceed specified limits.

See the example below for rebate calculation under Section 87A.

Under the **new tax regime**, for individuals below 60 years of age for AY 2025 -26

Source of income (FY 2024-25)	**Income (Rs)**
Gross total income	7,00,000
Less: Deduction under section 80C*	NA
Total income	7,00,000
Income-tax (@ 5% from Rs 3 lakh to Rs 7 lakh)	20,000

Less: Rebate u/s 87A	**20,000**
Tax payable	Nil

*** Deduction under section 80C is not eligible for the taxpayer who pays tax under the new tax regime .**

Under the **old tax regime**, For individuals below 60 years of age for AY 2025-26

Source of income (FY 2024-25)	**Income (Rs)**
Gross total income	6,50,000
Less: Deduction under section 80C*	1,50,000
Total income	5,00,000
Income-tax (@ 5% from Rs 2.5 lakh to Rs 5 lakh)	12,500
Less: Rebate u/s 87A	**12,500**
Tax payable	Nil

***You can claim a deduction for tax-saving under Section 80C for eligible investments and expenditures, Section 80D for medical insurance, 80CCD for contribution to NPS, 80G for donations and other deductions to arrive at your total income.**

CHECK THE PROGRESS

Fill in the Blanks

1. Rebate under Section 87A is available only to ________ individuals.
   - **Resident**
2. A resident individual whose total taxable income does not exceed Rs. ________ under the new tax regime can claim a rebate of up to Rs. 60,000 for FY 2025-26.
   - **12,00,000**
3. The maximum rebate under Section 87A cannot exceed the total ________ before adding the cess.
   - **Tax payable**
4. To claim tax relief under Section 89(1), an individual must file Form ________.
   - **10E**
5. Rebate under Section 87A is not available for income earned through ________ capital gains.
   - **Long-term**
6. The health and education cess is ________ percent of the total tax payable after applying rebates.
   - **4%**

13.2.5 Rebate Against Various Tax Liabilities

Section 87A rebate can be claimed against tax liabilities on:

- Normal income which is taxed at the slab rate
- Long-term capital gains under Section 112 of the Income Tax Act. (Section 112 applies for long-term capital gains on the sale of any capital assets other than listed equity shares as well as equity-oriented schemes of mutual funds)
- Short-term capital gains on listed equity shares and equity-oriented schemes of mutual funds under Section 111A of the Act, on which tax is payable at a flat rate of 15%.

13.2.6 Rebate Limit Under Section 87A for the Different Financial Years

Financial Year	Tax Regime	Taxable Income Limit	Rebate Amount (u/s 87A)
2025-26	New Regime	Rs. 12,00,000	Rs. 60,000
	Old Regime	Rs. 5,00,000	Rs. 12,500
2024-25	New Regime	Rs. 7,00,000	Rs. 25,000
	Old Regime	Rs. 5,00,000	Rs. 12,500
2023-24	New Regime	Rs. 7,00,000	Rs. 25,000
	Old Regime	Rs. 5,00,000	Rs. 12,500
2022-23	Both Regimes	Rs. 5,00,000	Rs. 12,500
2021-22	Both Regimes	Rs. 5,00,000	Rs. 12,500
2020-21	Both Regimes	Rs. 5,00,000	Rs. 12,500

CHECK THE PROGRESS

True or False

1. Rebate under Section 87A is available only to non-resident individuals.
   - False
2. Section 87A rebate can be applied to tax liability after adding health and education cess.
   - False
3. A resident individual with a total taxable income of Rs. 6,50,000 under the old tax regime can claim a rebate of Rs. 12,500.
   - True
4. Relief under Section 89(1) can only be claimed if salary is received in arrears.
   - False
5. Tax relief under Section 89(1) is only applicable to income from salary arrears, and not from other sources like gratuity or provident fund.
   - False
6. The maximum rebate limit under Section 87A for FY 2025-26 in the new regime is Rs. 60,000 for income up to Rs. 12 lakh.
   - True

13.3 RELIEF OF TAX

13.3.1 Relief under Section 89(1)

Tax is calculated on your total income earned or received during the year. If your total income includes any past dues paid in the current year, you may be worried about paying a higher tax on such arrears (usually, tax rates have gone up over the years plus the addition of past income increases your tax slab rate).

To save you from any additional tax burden due to delay in receiving income, the tax laws allow a relief under section 89(1). In simple words, you do not pay more taxes if there was a delay in payment to you and you were in a lower tax bracket for the year you received the money.

An employee must meet certain conditions to claim relief under this section. To start with, Section 89 reliefs can be claimed on any of the following received during a particular year:

a) Salary received in arrears or in advance

b) Premature withdrawal from Provident Fund

c) Gratuity

d) Commuted value of pension

e) Arrears of family pension

f) Compensation on termination of employment

13.3.2 How to Calculate Tax Relief under Section 89(1) on Salary Arrears?

If in case of receipt of past salary, salary in advance or receipt of family pension in arrears, you are allowed some tax relief under section 89(1).

Here's how you can calculate the tax relief yourself –

Step 1:

Calculate tax payable on the total income, including additional salary – in the year it is received. The arrears provided will reflect in Part B of Form 16.

Step 2:

Calculate tax payable on the total income, excluding additional salary in the year it is received. You can get the amount of additional salary (Arrears) from the arrear document given by your employer. You have to subtract the arrears from the total salary received (including the arrears), which can be taken from your Form 16. This calculation will give you the exact amount of tax liability in the given year if there were no arrears.

Step 3:

Calculate the difference between Step 1 and Step 2.

This will give you the additional tax liability created due to arrears of income.

Step 4:

Calculate tax payable on the total income of the year to which the arrears relate, excluding arrears.

Step 5:

Calculate tax payable on the total income of the year to which the arrears relate, including arrears

Step 6:

Calculate the difference between Step 4 and Step 5.

This will calculate the actual tax liability in any past year pertaining to which arrears have been received in the current year, had the full arrears received in the same past year.

Step 7:

Excess of the amount at Step 3 over Step 6 is the tax relief that shall be allowed. If the amount in Step 6 is more than the amount in Step 3, no relief shall be allowed. Alternatively, you may follow the steps on the income tax website to calculate the tax arrears. Once you have calculated this amount, you can enter the values on ClearTax and proceed to file your return.

13.3.3 Filing Form 10E

To claim the benefits under section 89(1), filing **Form 10E** is mandatory. You can file this form online on the income tax e-filing portal. To access the form, you must log in to your account.

13.4 LET US SUM UP

In this lesson, we have explored the concepts of *rebate* and *relief of tax,* which are important aspects of the Indian taxation system designed to reduce the tax burden on eligible taxpayers.

1. Rebate under Section 87A is available to resident individuals who meet certain income criteria, providing a reduction in the tax liability based on the total taxable income. The rebate amount varies across financial years, with specific limits for both the new and old tax regimes.
2. Relief of Tax under Section 89(1) comes into play when an individual receives salary or other income arrears, which may push them into a higher tax bracket. This relief helps mitigate the additional tax burden caused by delayed payments and ensures fairness in taxation.

Understanding the eligibility criteria, calculation methods, and procedures for claiming rebates and reliefs allows taxpayers to optimize their tax planning and minimize their liabilities. By following the steps for calculating tax rebates and reliefs accurately, individuals can ensure they receive the benefits they are entitled to under the law.

CHECK THE PROGRESS

One-word questions based on the content:

1. Which section provides a rebate to resident individuals?
    - Section 87A
2. What is the maximum rebate allowed under Section 87A for FY 2025-26 in the new regime?
    - Rs. 60,000
3. Which form must be filed to claim relief under Section 89(1)?
    - Form 10E
4. What is the percentage of health and education cess added to the tax payable?
    - 4%
5. Which regime provides a rebate for incomes up to Rs. 5 lakh?
    - Old
6. What type of income is NOT eligible for rebate under Section 87A?
    - Long-term capital gains
7. Which section provides tax relief on salary arrears?
    - Section 89(1)
8. Which tax regime offers a rebate for individuals earning up to Rs. 7 lakh in FY 2024-25?
    - New
9. Who is eligible to claim a rebate under Section 87A?

- Resident

10. What is the maximum tax relief under Section 89(1) related to?
    - Arrears

13.5 KEYWORDS

Rebate: A tax reduction available to eligible taxpayers based on their income, reducing their overall tax liability. It is a direct deduction from the calculated tax payable before adding any cess.

Relief of Tax: A provision that allows taxpayers to avoid paying excessive tax on income received in arrears or in advance. It ensures taxpayers are not penalized with higher taxes for delayed payments.

Section 87A: A section in the Income Tax Act that provides a rebate to resident individuals based on their income level, reducing their tax liability.

Health and Education Cess: An additional tax of 4% on the total tax liability to fund health and education programs in India.

Tax Regime: The set of tax rules under which a taxpayer is assessed, including the new and old regimes with different slabs and rebate options.

Arrears: Income received for previous years, which could cause the taxpayer to fall into a higher tax bracket when received in the current year.

Form 10E: A form that must be filed to claim tax relief under Section 89(1) for income arrears.

Section 89(1): A section that provides tax relief to taxpayers who have received income arrears or advance payments, helping to reduce the additional tax burden caused by the timing of the income receipt.

13.6 SELF ASSESSMENT QUESTIONS

1. What is the purpose of tax rebates in the income tax system? Explain with examples.

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2. What is a tax rebate?

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3. Which section of the Income Tax Act provides a rebate for individuals earning up to Rs. 7 lakh?

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13.7 LESSON END EXERCISE

1. What is the purpose of filing Form 10E?

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2. What is the purpose of tax reliefs in the income tax system? Explain with examples.

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3. What is the maximum rebate available under Section 87A for FY 2024-25?

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13.8 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

UNIT – III **B.COM 4th SEMESTER**

COURSE No. BCG-402 **LESSON No. 14**

HINDU UNDIVIDED FAMILY

STRUCTURE

14.0 Learning Objectives and Learning Outcomes

14.1 Introduction

14.2 Hindu Undivided Family

14.3 HUF Tax Slabs

14.4 Residence of HUF

14.5 Members of HUF

14.6 Types of members

14.7 How to Form an HUF

14.8 Tax Implications of Forming a HUF

14.9 Let Us Sum Up

14.10 Keywords

14.11 Self-Assessment Questions

14.12 Lesson End Exercise

14.13 Suggested Readings

14.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Learn what a Hindu Undivided Family (HUF) is and how it is different from individual tax assessments.
- Understand how HUFs are taxed and what tax benefits they can receive under the Income Tax Act.
- Get familiar with the steps to create an HUF, including the paperwork and requirements needed.
- Learn how forming an HUF can help save taxes through income splitting and claiming deductions.

Learning outcomes

- Be able to explain what an HUF is and who can be part of it.
- Understand the tax slabs for HUFs and how they are taxed separately from individuals.

- Be able to list the steps needed to create an HUF, including the legal paperwork.
- Understand how an HUF can help save taxes through income splitting and deductions like Section 80C.

14.1 INTRODUCTION

A Hindu Undivided Family (HUF) is a unique legal and tax entity in India that is formed under Hindu Law. It consists of individuals who are lineally descended from a common ancestor and their spouses and unmarried daughters. While an HUF may not necessarily have joint property, it can be formed whenever a Hindu gets married and has children. The HUF can have distinct tax benefits, and it is taxed separately from its members. This structure is primarily recognized under Indian tax law and can be used to save taxes through certain deductions, exemptions, and property income splitting. Understanding how to form an HUF, its tax implications, and how it functions is important for both tax planning and wealth management.

14.2 HINDU UNDIVIDED FAMILY

The term 'Hindu undivided family' has not been defined in the Income-tax Act. However, in general parlance it means an undivided family of Hindus. Creation of a HUF is a God-gifted phenomenon. As soon as a married Hindu gets a child, a new HUF comes into existence. It is not at all necessary that every HUF must have joint property or family income. [R.SubramaniaIyer v. CIT (1955) 28, ITR, 352]. However, to become an assessee under the Income-tax Act, there must be 'income-yielding' joint property of the family.

A HUF may consist of a number of smaller HUFs. A smaller HUF has a legal existence and may be assessable as a unit distinct from the apex joint family even when the bigger HUF is in place [CIT v. Khanna (1963) 49 ITR 232].

Under Hindu Law, a Joint Hindu Family consists of all persons lineally descended from a common ancestor (except those who have separated from the joint family by partitioning of assets) and includes their wives and unmarried daughters, and also a stranger who has been adopted by the family. [Surjit lal Chhabra v. CIT (1975) 101, ITR, p.776 (S.C.)].

The Supreme Court's decision in the case of Surjit Lal Chhabra v. CIT (1975 101 ITR 776) has come to stay as one of the leading case laws. The ratio laid down by the Supreme Court had been applied by the Andhra Pradesh, Orissa and Madras High Courts, followed by Bombay, Patna, Madhya Pradesh and Delhi High Courts and relied upon by the Punjab High Court. In the latest case, the Delhi High Court held in Commissioner of Income-tax v. S.P. Chopra (1991, 191 ITR 455) that the income from the half share of the property had to be treated as the individual income of the assessee under the personal law and not as income of the family. The character of the property had to be determined in accordance with the personal law of the assessee and not on the basis of how the property had been treated by the revenue in respect of earlier assessments.

A son conceived or in his mother's womb is equal in many respects to a son actually in existence, viz., inheritance, partition, survivorship etc. But this doctrine does not apply to the Income-tax Act. Hence, a son conceived is not treated a member of the H.U.F. for Income-tax purposes. [T.S. Srinivasan v. C.I.T., (1966) 60, ITR, p.36 (S.C.)].

Jain and Sikh undivided families are also treated as Hindu undivided families unless, under special circumstances, the assessee claims not to be treated as such. If such claim is made, the assessee shall have to prove that there is some such custom in his family on account of which it cannot be treated as a Hindu undivided family.

A Hindu does not cease to be a Hindu merely because he declared for the purpose of the Special Marriage Act, 1872, that he does not profess Hindu Religion. Such a Hindu does form an H.U.F. with his children from such marriage. [CIT v. Partap Chand (1959), 36 ITR, 262]. Similarly, a Muslim family governed by the Marumakkathayam law constitutes 'Tarwad' or 'Thavazhi' and falls within the definition of a H.U.F. [V.K.P. Abdul Kadar Haji v. Ag. ITO (1967) 66, ITR, 173].

If a Hindu gets converted as a Christian, the family of such a person will not be a HUF. However a Hindu, along with his son (by a christian wife) who has been brought up as a Hindu will be a HUF. [CWT v. R. Sridharan (1976) 104, ITR, 436 (S.C.)].

What is a HUF?

- A Hindu Undivided Family (HUF) is a separate legal entity and taxed separately from its members.
- HUF can be formed by Hindu, Sikh, Jain, or Buddhist families.
- The head of the HUF is called the Karta, usually the eldest male or a senior female.
- Members include coparceners (sons and daughters) and other family members (e.g., wife, daughter-in-law).
- It is eligible for the same tax slabs and deductions as an individual.
- HUF has its own PAN and files tax returns independent of its members.

CHECK THE PROGRESS

One Word Questions:

1. What is the head of a Hindu Undivided Family called?
   - Answer: Karta
2. Which law governs the creation of an HUF?
   - Answer: Hindu Law
3. What is the legal entity that can be formed when a Hindu gets married and has children?
   - Answer: Hindu Undivided Family (HUF)
4. What is the document required to form an HUF?
   - Answer: HUF Deed

14.3 HUF TAX SLABS

Hindu Undivided Family (HUF) is taxed at slab rates that is applicable for individuals. Even a HUF can opt for new regime or old tax regime, depending on his level of income and tax-saving options available. The income tax slab rates applicable for HUF is given below:

New Regime Tax Slabs FY 2025-26

Income Tax Slabs	Income Tax Rates
Up to Rs. 4 lakh	NIL
Rs. 4 lakh - Rs.8 lakh	5%
Rs. 8 lakh - Rs.12 lakh	10%
Rs.12 lakh - Rs.16 lakh	15%
Rs.16 lakh - Rs. 20 lakh	20%
Rs. 20 lakh - Rs. 24 lakh	25%
Above Rs. 24 lakh	30%

New Regime Tax Slabs FY 2024-25

Income Tax Slabs	Tax Rates
Up to Rs. 3 lakh	NIL
Rs. 3 lakh - Rs.7 lakh	5%
Rs. 7 lakh - Rs. 10 lakh	10%
Rs. 10 lakh - Rs. 12 lakh	15%
Rs. 12 lakh - Rs. 15 lakh	20%
Above Rs. 15 lakh	30%

Old Tax Regime Slabs for FY 2025-26 & FY 2024-25

Income Slabs	Income Tax Rates
Up to Rs. 2.5 lakh	NIL
Rs. 2.5 lakh - Rs. 5 lakh	5%
Rs. 5 lakh - Rs. 10 lakh	20%
Above Rs. 10 lakh	30%

Surcharge and cess will be applicable.

14.4 RESIDENCE OF HINDU UNDIVIDED FAMILY

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

If the Karta of a Hindu Undivided Family (HUF) is resident and ordinarily resident in India, then the HUF is also treated as resident and ordinarily resident.

However, if the Karta is resident but not ordinarily resident, then the HUF is considered resident but not ordinarily resident.

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

14.5 MEMBERS OF HUF

- The head of HUF is called Karta.
- There should be minimum 2 members to form a HUF.
- Members include all individuals in the family, such as the grandfather, father, son, grandson, mother, wife, and unmarried daughters.

- Coparceners, however, are a subset of members. They are those who acquire their status in the HUF by birth.
- They include male and female descendants, but not women who marry into the family—they are members but not coparceners.
- Importantly, only coparceners have the legal right to demand partition of the HUF property.
- Daughters are also considered as co-parceners. Being a coparcener, she can claim the partition of assets of the family.
- All the coparceners are liable for their proportion of the share in HUF. Whereas, Karta has unlimited liability on the dues of HUF, including tax dues.

CHECK THE PROGRESS

MCQs:

1. **Which of the following is true about an HUF?**
   - A) It is taxed under corporate tax rules.
   - B) It is a separate tax entity from its members.
   - C) It cannot have its own PAN.
   - D) It is formed only when a person turns 30.
   - **Answer:** B) It is a separate tax entity from its members.
2. **Who can be the Karta of an HUF?**
   - A) Only the eldest son
   - B) Only the eldest male member
   - C) Any family member, male or female
   - D) The wife of the eldest male member
   - **Answer:** B) Only the eldest male member
3. **What is the tax rate for an HUF under the new tax regime for an income above Rs. 24 lakh in FY 2025-26?**
   - A) 25%

- B) 30%
- C) 10%
- D) 20%
- **Answer:** B) 30%

4. **Which of the following can claim a deduction under Section 80C in an HUF?**
   - A) Only the Karta
   - B) The HUF and its members
   - C) Only male members
   - D) None of the above
   - **Answer:** B) The HUF and its members

14. 6 TYPES OF MEMBERS

A Hindu Joint Family consists of two types of members:

(i) Coparceners: The lineal male descendants of a person up to the third generation of such person are known as coparceners. The coparceners acquire, on birth, ownership in the ancestral properties of such ascendant and have a right to claim partition of such property at any time. However, w.e.f. 9.9.2005 due to amendment of Hindu Succession Act, the daughter of a coparcener shall by birth become a coparcener in her own right in the same manner as the son. Hence, the daughter can also ask for partition.

(ii) Other members: Such members include wives of male members of the family and other male members.

Thus, a Hindu Joint Family may consist of:

(a) All persons lineally descended from a common ancestor and includes their wives and daughters (w.e.f. 9.9.2005).

(b) A male and widow or widows of deceased male member or members. [GowliBuddanna v. C.I.T. (1966) 60, ITR, p. 293 (S.C.)]

However, an unmarried coparcener who receives share on the partition of joint family properties, cannot form a Hindu undivided family unless he marries. After his marriage, he can hold the property received from family as joint family property consisting of himself and his wife. [C. Krishna Prasad v. C.I.T. (1974) 97, p. 493 (S.C.)].

Karta: Property of the family is ordinarily managed by the father or other senior member for the time being of the family. He is called Karta. However, the senior member may give up his right of management and a junior member may be appointed as Karta with the consent of all other members. [Narendra Kumar J. Modi v. CIT (1976) 105, ITR, 109 (S.C.)]. In the absence of a male member in the family or when all male members are minors, a woman member can be treated as manager of the family for income-tax purposes. [Smt. ChampaKumariSinghi v. Addl. Member of the Board of Revenue (1962) 46, ITR, p. 81].

Since daughter is also a copacener w.e.f. 9.9.05, it may be presumed that daughter can also be karta of her father's HUF.

14. 7 HOW TO FORM AN HUF

Step - 1: Draft a legal deed in a stamp paper, clearly specifying the structure, members, Karta, coparceners, and business of HUF. The members of HUF should sign on the deed.

Step - 2 : Obtain a separate PAN for HUF.

Step - 3: Create a separate bank account for HUF.

One person cannot form HUF, it can only be formed by a family. A HUF can be created upon marriage. It includes the husband, wife and their children.

14.8 TAX IMPLICATIONS OF FORMING A HUF

- A HUF is taxed separately from its members. It has its own PAN and files a separate tax return.
- Therefore, it can claim deductions or exemptions allowed under the tax laws separately. For example, if you and your spouse along with your 2 children decide to create an HUF, all four of you as well as the HUF can claim a deduction for Section 80C.
- HUF can pay a salary to its members if they contribute to its functioning of the HUF. This salary expense can be deducted from the income of HUF.
- Investments can be made from HUF's income. Any returns from these investments are taxable in the hands of the HUF.
- A HUF is taxed at the same rates as an individual.

How to Save Taxes by Forming HUF - An Illustration

Let's understand how an HUF is taxed with an example – After the death of his father, Mr Rajesh Chopra decides to start a HUF with his wife, son, and daughter as members. Since Mr Chopra had no siblings, the property held by his father was transferred in the name of the HUF. The property held by late Mr Chopra earns an annual rent of Rs 7.5 lakhs. Mr Rajesh Chopra has an income from salary of Rs 20 lakh. By creating a HUF, Mr Chopra can save tax, see below.

Income from Various Sources	**Individual's Return**	**HUF's Return**	
	Income of Mr. Chopra before formation of HUF	**Income of Mr. Chopra after formation of HUF**	**Income of HUF**
A) Salary	20,00,000	20,00,000	
B) House property rent	7,50,000	–	7,50,000
C) Standard deduction on house property (30% of 7,50,000)	(2,25,000)	–	(2,25,000)
D) Income from house property (B-C)	5,25,000	–	5,25,000
Total Taxable Income (A+D)	25,25,000	20,00,000	5,25,000
Section 80C	(1,50,000)	(1,50,000)	(1,50,000)
Net Taxable Income (E-F)	23,75,000	18,50,000	3,75,000
Tax Payable (calculations based on Slab rates of the old regime including health and education cess of 4%)	5,46,000	3,82,200	6,500

Total tax paid by Mr. Chopra	5,46,000
Total tax paid by Mr. Chopra & HUF	3,88,700
Tax saving due to forming an HUF	1,57,300

Due to this tax arrangement, Mr Chopra saved tax of Rs 1,57,300. Both HUF and Mr Chopra (as well as other members of the HUF) can claim a deduction under section 80C. Furthermore, the income of the HUF can be invested by the HUF and will continue to be taxed in the hands of the HUF.

CHECK THE PROGRESS

True/False Questions:

1. A daughter born into an HUF has the same rights as a son.
   - Answer: True
2. An HUF can be created by a single person.
   - Answer: False
3. The Karta of an HUF has unlimited liability for the family's debts, including taxes.
   - Answer: True
4. HUFs are taxed at the same rates as individual taxpayers under the Income Tax Act.
   - Answer: True

14.9 LET US SUM UP

The concept of Hindu Undivided Family (HUF) provides a unique tax-saving opportunity, particularly for families with ancestral property or a steady family income. By understanding the roles, structure, and tax laws governing an HUF, families can optimize their tax planning and financial management. Moreover, the ability to split income between the family members and the HUF itself ensures that the family as a whole benefits from reduced tax liabilities. In essence, the HUF model fosters better wealth management while ensuring compliance with the Income-tax Act.

14.10 KEYWORDS

The term **'Hindu undivided family'** has not been defined in the Income-tax Act. However, in general parlance it means an undivided family of Hindus. Creation of a HUF is a God-gifted phenomenon. As soon as a married Hindu gets a child, a new HUF comes into existence. It is not at all necessary that every HUF must have joint property or family income.

A Hindu Joint Family consists of **Coparceners & members**.

Coparceners: The lineal male descendants of a person upto the third generation of such person are known as coparceners. The coparceners acquire, on birth, ownership in the ancestral properties of such ascendant and have a right to claim partition of such property at any time.

Karta: Property of the family is ordinarily managed by the father or other senior member for the time being of the family. He is called Karta. However, the senior member may give up his right of management and a junior member may be appointed as Karta with the consent of all other members. [Narendra Kumar J. Modi v. CIT (1976) 105, ITR, 109 (S.C.)].

14.11 SELF ASSESSMENT QUESTIONS

1. Discuss the meaning of Hindu Undivided Family?

2. What are the basic requirements to form an HUF?

3. How can forming an HUF help in tax saving?

14.12 LESSON END EXERCISE

1. What is Karta?

2. Who can be a member of an HUF?

3. What do you mean by Coparceners**?**

14.13 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

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7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

ASSESSMENT OF HUF

STRUCTURE

15.0 Learning Objectives and Learning Outcomes

15.1 Introduction

15.2 Joint property of the family

15.3 Position under Hindu Succession Act, 1956

15.4 Computation of income of the HUF

15.5 Partition of a HUF

15.6 Practical Problem

15.7 Let Us Sum Up

15.8 Keywords

15.9 Self Assessment Questions

15.10 Lesson End Exercise

15.11 Suggested Readings

15.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand different types of joint property in HUF (ancestral, accretion, joint funds, self-acquired property).
- Learn the legal rights of female members in an HUF regarding property and inheritance.
- Understand the two schools of Hindu law (Mitakshara and Dayabhaga) and their impact on family property and partition.
- Learn how to calculate HUF income and tax, including business income, remuneration, and other sources.

Learning outcomes

- Identify different types of HUF property and how they are treated legally.
- Explain the rights of women in the HUF regarding property.
- Distinguish between Mitakshara and Dayabhaga laws in terms of property rights and succession.
- Calculate and assess HUF income and understand tax obligations related to it.

15.1 INTRODUCTION

The Hindu Undivided Family (HUF) is a unique concept in Indian law that allows a family to hold property together as a single unit. It is governed by Hindu Law and is recognized by the Income Tax Act. The structure of HUF is important because it impacts inheritance, taxation, and family property rights. The HUF can consist of ancestral property, acquired property, or even a female member's self-acquired property, depending on the law under which the family operates (Mitakshara or Dayabhaga). This topic discusses the classification of HUF property, the rights and duties of its members, particularly the Karta, and the taxation structure for HUFs under the Income Tax Act. Understanding these principles is essential for managing family assets, calculating taxes, and understanding legal rights in Hindu family structures.

15.2 JOINT PROPERTY OF THE FAMILY

It consists of:

(i) Ancestral property;

(ii) Accretion thereto;

(iii) Acquisition with joint funds; and

(iv) Self-acquired property of any member thrown by him into the common stock to be treated as family property. In the case of Pushpa Devi v. C.I.T. the Supreme Court has held that a Hindu female, not being a coparcener, cannot blend her separate property with Joint family property. However, she can make a gift of her property to the family. [(1977) 109, ITR p. 730].

The Supreme Court's decision in the case of Pushpa Devi v. Commissioner of Income-tax (1977, 109 ITR 730) had been later followed by the Calcutta, Andhra Pradesh and Madras High Courts. In the latest case, the Madras High Court held in the case of RajathyAmmal v. Commissioner of Wealth-tax (1987, 164 ITR 605) that a female member could not throw her property into the family hotchpotch and the only way she could achieve her purpose was either by gifting it or selling to the family.

Further, Section 64(2) provides that where an individual being a member of Hindu undivided family transfers his separate property after 31st December, 1969 to the family for the common benefit of the family, otherwise than for adequate consideration, such property is known as converted property. The income derived from the converted property or any part thereof shall be included in the total income of the transferor individual and not in the income of the family.

School of Hindu Law: According to Hindu Law, HUFs are governed by two schools viz. **Mitakshara and Dayabhaga.**

Mitakshara School applies to whole of India except the states of West Bengal and Assam.

Dayabhaga School applies to the States of West Bengal and Assam. The difference between the two schools is as under:

(i) Foundation: In the Mitakashara School, the foundation of a coparcenary is laid down when a son is born to the Mitakshara father. Under the Dayabhaga School the foundation of a coparcenary is laid on the death of the father leaving, as survivors, one or more sons.

(ii) Right to partition: A Mitakshara son, in whom the interest in family property is vested by birth, all along possesses a right to demand partition. A Dayabhaga son, on the other hand acquires no interest in the family property by birth and, consequently, has no right to demand partition of the HUF property from his father.

(iii) Quantum of share: Under Mitakshara Law, each coparcener takes as undefined share in the coparcenary property. The share of the members decreases by birth in the family and increases upon death of a coparcener. A Dayabhaga coparcener, on the other hand, always takes a defined share in the property left by his deceased father. Thus, the heirs of a deceased governed by the Dayabhaga School do not constitute a HUF automatically on the death of the deceased and cannot be assessed as a HUF unless they have by mutual consent agreed to form a joint family.

(iv) Gift out of ancestral property: A Mitakshara Karta may make a gift of movable property of the family, out of love and affection, within reasonable limits. He can also make a gift of immovable properties, within reasonable limits for pious purposes; i.e., for charitable and religious purposes or to a daughter in fulfilment of a nuptial promise etc. However, a gift to a stranger is void. On the contrary, a Dayabhaga father can alienate ancestral property, both movable as well as immovable, by sale, gift, will or otherwise in the same way as he can dispose of his separate property.

15.3 POSITION UNDER HINDU SUCCESSION ACT,1956

This Act came into force on and from **17th June, 1956**. It lays down a uniform and comprehensive system of inheritance and applies to persons governed by the Mitakshara as well as the Dayabhaga Schools, superseding and abrogating all previous law or customs or usage having the force of law. Under this Act, the heirs of a male Hindu dying intestate on or after 17th June, 1956 are divided into three classes. Class I heirs get the right to the deceased's property simultaneously to the exclusion of all other Classes of heirs. Class II relations succeed only if there is no class I relation and, the heirs in the first entry of class II being preferred to heirs in the second entry, and so on, but heirs in any one entry taking in equal shares amongst themselves.

The students should note that Section 4 of the Hindu Succession Act, 1956 clearly lays down that "save as otherwise expressly provided in the Act, any text, rule or interpretation of Hindu Law or any custom or usage as part of that law in force immediately before the commencement of the Act shall cease to have effect with respect to any matter for which provision is made in the Act." And, Section 8 of the Hindu Succession Act, 1956, lays down the scheme of succession to the property of a Hindu dying intestate. The schedule classifies the heirs on which such property shall devolve.

The preferential heirs of class I are as under:

(1) Son (2) Daughter (3) Widow (4) Mother (5) Son/daughter/widow of a predeceased son (6) son/daughter of a predeceased daughter (7) Son/daughter/ widow of a predeceased son of a predeceased son.

A son's son is not mentioned as an heir under Class I of the schedule and, therefore, he cannot get any right in the property of his grandfather under the provision. The right of a son's son in his grandfather's property during the lifetime of his father which existed under the Hindu Law as in force before the Act, is not saved expressly by the Act and, therefore the earlier interpretation of Hindu Law giving a right by birth in such property 'ceased to have effect'.

Therefore, the property which devolves on a Hindu on the death of his father intestate after coming into force of the Hindu Succession Act, 1956, does not constitute H.U.F. property consisting of his own branch including his sons. [Shri VallabhdasModani v. C.I.T. (1982) 138, ITR, p. 673].

The Allahabad High Court's decision supra in the case of Shri VallabhdasModani v. Commissioner of Incometax was followed by the Andhra Pradesh High Court (1983, 144 ITR 18) and later approved by the Supreme Court in the case of Commissioner of Wealth-Tax v. Chander Sen (1986, 161 ITR 370) holding that it is not possible to say that when a son inherits the property in the situation contemplated by the Hindu Succession Act, 1956, he takes as Karta of his own undivided family.

CHECK THE PROGRESS

Fill-in-the-Blanks:

1. The Hindu Undivided Family (HUF) is governed by the _____________ system of law.
2. Under the Hindu Succession Act, 1956, property of a Hindu male dying intestate will devolve to his heirs under _____________ class.
3. In the Mitakshara system, a coparcener's share in family property is _____________ by the birth of new members.
4. A Hindu female can make a gift of her property to the HUF but cannot _____________ her separate property into the joint family property.
5. A partition of the HUF that occurs after December 31, 1978, involving only a portion of the property, is termed a _____________ partition.

ANSWERS

1. Mitakshara
2. Class I
3. Reduced
4. Blend
5. Partial

15.4 COMPUTATION OF INCOME OF THE HUF

The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assessees. However, in this connection the following points are worth noting:

(i) If the funds of a Hindu Undivided family are invested in a company or a firm, fees or remuneration received by the member as a director, or a partner in the company or firm may be treated as income of the family in case the fees or remuneration is earned essentially as a result of investment of funds. But, if the fees or remuneration is earned essentially for services rendered bythe member in his personal capacity, the income shall constitute the personal income of the member.

(ii) For determining whether a particular income belongs to a member of the family or to his undivided family, the Supreme Court has enunciated certain principles. The question to be considered in such cases is, whether the remuneration received by the coparcener is in substance merely a mode of return made to the family because of the investment of the family funds in the business or whether it is a compensation for services rendered by the coparcener. If it is the former, it is an income of the HUF but if it is the latter it is the income of the individual. If the income was essentially earned as a result of the funds invested, the fact that a coparcener has rendered some service would not change the character of the receipt. But if, on the other hand, it is essentially a remuneration for the services rendered by the coparcener, the circumstances that his services were availed of because of the reason that he was a member of the family which had invested funds in that business or that he had obtained the qualification shares from out of the family funds would not make the receipt the income of the HUF. [Raj Kumar Singh HukamChandji v. CIT (1970) 78 ITR 33].

The Supreme Court's decision supra in the case of Raj Kumar Singh HukamChandji v. Commissioner of Income-tax has come to stay as one of the most followed/applied case laws. This decision had been followed by Patna (Full Bench), Allahabad, Bombay and Gujarat High Courts, applied by Andhra Pradesh, Madras, Kerala, Delhi, and Supreme Court itself. It would suffice to refer to the Supreme Court's decision in the case of Y.L. Aggarwalla and others v. Commissioner of Income-tax (1978, 114 ITR 471) holding that the share income was a return made to the family because of the investments of the family funds in the business and the share income was not the individual income of minor sons but was the income of the Hindu undivided family and had to be assessed in the hands of the family.

(iii) Where a member of a HUF is a partner in a firm on behalf of the family and on partition of the property of the family, the share in the firm is allotted to such a member, subsequent to such allotment when the firm settles its accounts the whole income for that year would be the income of the individual member and no part of the income would be added to the income of the family. [CIT v. Ashok Bhai Chiman Bhai (1965) 56, ITR, 42 (S.C.)].

(iv) The personal earning, including income from self-acquired property of a member of the HUF, even though he has sons, would not be included in the income of the family. Such income shall be assessed as income of that individual. [KalyanjiVithal Das v. CIT (1937) 5 ITR 90 (PC)].

(v) Any sum paid by an H.U.F to a member of the family out of its income is not deductible in computing the income of the family. However, such amount will not be included in the income of such individual whether the family had paid tax on its income or not [Section 10(2)].

(vi) If any remuneration is paid by the Hindu Undivided family to the karta or any other member for services rendered by him in conducting family's business, the remuneration is deductible if remuneration is (a) paid under a valid and bona fide agreement; (b) in the interest of, and expedient for, the business of family; and (c) genuine and not excessive. Jugal Kishore BaldeoSahai v. CIT [1967] 63 ITR 238 (SC).

(vii) If salary is paid by the Hindu undivided family to its karta for looking after its interest in firms in which it is partner through said karta, such salary is allowable as deduction - CIT v. Prakash

Chand Agarwal [1982] 11 Taxman 55 (MP).

(viii) Income from 'stridhan' is not includible in the income of the family. Property derived by a woman from her father or brother or husband or any other relative either before or after her marriage is known as 'stridhan'.

(ix) If a member has converted or transferred without adequate consideration after December 31, 1969 his self-acquired property into joint family property, income from such property is not taxable in the hands of the family.

(x) Income from impartible estate is taxable in the hands of the holder of the estate and not in the hands of the Hindu undivided family. Though, the impartible estate belongs to the family, income arising therefrom belongs to the holder of the estate who is the senior most male member of the family. Income from impartible estate is taxable in the hands of the holder of the estate.

(xi) Personal income of the members cannot be treated as income of Hindu undivided family.

(xii) Under the DayabhagaSchool of law, as stated in a preceding page, no son has any right in the ancestral property during the lifetime of his father. If, therefore, the father does not have any brother as a coparcener, income arising from ancestral property is taxable as his individual income.

15.5 PARTITION OF A HINDU UNDIVIDED FAMILY (Section 171)

'Partition' signifies division of property. In the cases of property capable of physical division, share of each member is determined by making physical division thereof. It must be noted that a division of income without physical division of property does not amount to partition. Where, however, the property is not capable of physical division, partition implies such division as the property may admit.

- ***Who is entitled to share on partition***

Though only coparceners can demand partition, once the partition takes effect, the following persons are entitled to a share:

(a) All coparceners;

(b) A son in the womb of his mother at the time of partition;

(c) Mother, who gets an equal share if the partition takes place among her sons after the death of her husband; and

(d) Wife, who gets a share equal to that of a son at the time of a partition between father and sons.

- ***Assessment after partition (Section 171)***

A joint family, once assessed as a HUF, continues to be assessed as such till one or more coparceners claim partition. Such claim must be made by the coparceners before the assessment of the income of the HUF for the relevant assessment year is completed. On the receipt of such a claim, the Assessing Officer must make an inquiry after giving due notice to the members and record a finding whether there has been a partition and, if so, the date of the partition. The income of the family from the first day of the previous year to the date of partition is assessed as income of the HUF and from the next date of the partition to the date of close of the previous year, as the individual income of the recipient-members. If the recipient member forms another HUF along with his wife and son(s), the income of the property which was subject to partition is chargeable to tax in the hands of the new H.U.F.

- ***A partition of the HUF can be both total and partial***

Where the entire joint family property is divided among all coparceners and the family ceases to exist as an undivided family, the partition is total. A partial partition may be as regards: (a) the persons constituting the joint family, or (b) the properties belonging to the joint family, or (c) both. The device of partial partition has been used as a medium for reduction of proper tax liability. To curb such a practice, the Finance (No. 2) Act, 1980 inserted Sub-section 9 in Section 171 which lays down that partial partitions of HUFs effected after 31st Dec., 1978 will not be recognised for tax purposes.

The provisions made by Sub-section (9) in Section 171 are as follows:

(i) In a case where a partial partition of a HUF has taken place after 31.12.1978, no claim of such partition will be enquired into and the Assessing Officer will not record a finding as to whether there has been a partition of the family property. Further, any finding regarding partial partition recorded under Section 171(3) will be null and void and of no legal effect.

(ii) Such family will continue to be assessed as if no such partial partition has taken place, i.e., the property or source of income will be deemed to continue to belong to the Hindu undivided family and no member will be deemed to have separated from the family.

(iii) Each member or group of members of such family will be jointly and severally liable for any tax, interest, penalty, fine or other sum payable under the Act by the family, whether before or after such partition. The several liability of any member or group of members of such family will be computed according to the portion of the joint family property allotted to him on such partial partition. This amendment has come into force with effect from April 1, 1980 and has, accordingly, been applicable with effect from assessment year 1980-81 and onwards.

CHECK THE PROGRESS

Multiple Choice Questions (MCQs):

1. **Which of the following is a characteristic of the Mitakshara School?**
    - a) Property is inherited by sons only after the father's death.
    - b) Coparceners acquire their rights in the family property at birth.
    - c) Sons do not have any right in ancestral property.
    - d) It applies only to West Bengal and Assam.

Answer: b) Coparceners acquire their rights in the family property at birth.

2. **Which of the following is NOT included in the HUF property?**
    - a) Ancestral property
    - b) Self-acquired property of a member thrown into the common stock
    - c) A female member’s property blended with family property
    - d) A female member’s stridhan (personal property)

Answer: d) A female member’s stridhan (personal property)

3. **Who can demand partition in a Hindu Undivided Family?**
    - a) Only the Karta
    - b) Any coparcener
    - c) Only the father
    - d) Only the mother

Answer: b) Any coparcener

4. **Under the Hindu Succession Act, the Class I heirs include which of the following?**
    - a) Son and Daughter
    - b) Brothers and Sisters
    - c) Uncles and Aunts
    - d) Sons-in-law

Answer: a) Son and Daughter

5. **What is the main difference between the Mitakshara and Dayabhaga systems?**
    - a) Dayabhaga allows division of property after the father’s death.
    - b) Mitakshara recognizes the right of the son in ancestral property by birth.
    - c) Dayabhaga allows partition at any time.
    - d) Mitakshara does not allow partition.

Answer: b) Mitakshara recognizes the right of the son in ancestral property by birth.

15.6 PRACTICAL PROBLEM

ILLUSTRATION I

A HUF with more than one coparcener entitled to claim partition, owns a property which is let out at Rs. 600 per month per unit. The property consists of ten identical residential units. Following deductions are claimed by the HUF including the expenses on tenant's amenities.

Municipal rental Value for ten units(annual)	60,000
Municipal taxes	4200
Lift Maintenance	2000
Water pump expenses	800
Actual expenses on repairs	8000
Renovation to the property during the year	50,000
Edu. Cess levied by the state Govt.	2000
Rent collecters salary per month	200
Interest on loan taken against mortgage of the property but The money was actually used in the business of the HUF	5000

The income from business for the assessment year 2016-17 2,10,000 (After charging interest on loan)

A lottery ticket of 100 Rs. Was purchased out of family funds on the name of HUF and it won a prize of Rs. 100000. The Karta has acquired a shop out of his own savings which he gifted to his wife. Shop has an annual income of Rs 24000.

Compute the HUF's total income and tax payable for the assessment year 2025-26.

SOLUTION:-

Computation of Total Income for the Assessment Year 2025-26:

I. Income from House Property

- Annual Rental Value (ARV) = Rs. 60,000
- Municipal Taxes = Rs. 4,200
- Net Annual Value (NAV) = Rs. 60,000 - Rs. 4,200 = Rs. 55,800

Deductions under Section 24:

1. Standard Deduction (30% of NAV) = 30% of Rs. 55,800 = Rs. 16,740
2. Lift Maintenance = Rs. 2,000
3. Water Pump Expenses = Rs. 800

4. Actual Expenses on Repairs = Rs. 8,000
5. Interest on Loan for Property (for HUF business) = Rs. 5,000 (Note: This loan is used for business purposes, so it is not deducted under house property; it will be considered under business income)

Total Deductions under Section 24 = Rs. 16,740 + Rs. 2,000 + Rs. 800 + Rs. 8,000 = Rs. 27,540

Income from House Property = Rs. 55,800 - Rs. 27,540 = Rs. 28,260

II. Business Income

- Income from Business (after interest) = Rs. 2,10,000 (Given, already adjusted for interest on loan)
- Interest on loan (related to property) = Rs. 5,000 (This amount is claimed as business expense, so it is already included in the business income above)
- Income from Business = Rs. 2,10,000

III. Income from Lottery Prize

- Lottery Winnings = Rs. 1,00,000

  (Note: Income from lottery is taxed under the head "Income from Other Sources" and is taxable at a special rate of 30%)

IV. Income from the Shop Gifted to Wife (Karta's Own Savings)

- Income from Shop = Rs. 24,000

  (Since the shop was acquired by the Karta from his own savings, and it was gifted to his wife, the income from the shop will be included in the HUF's total income under the Income from Other Sources head, as it is still a part of the HUF's assets.)

V. Total Gross Income (GTI)

1. Income from House Property = Rs. 28,260
2. Income from Business = Rs. 2,10,000
3. Lottery Winnings = Rs. 1,00,000
4. Income from Shop = Rs. 24,000

Gross Total Income (GTI) = Rs. 28,260 + Rs. 2,10,000 + Rs. 1,00,000 + Rs. 24,000 = Rs. 3,62,260

VI. Deductions under Chapter VI-A

- Education Cess (Levy by State Government) = Rs. 2,000 (This is not eligible for deduction under the Income Tax Act, so we will not include it in deductions)

VII. Taxable Income After Deduction

Taxable Income = Gross Total Income (GTI) = Rs. 3,62,260 (since no Chapter VI-A deductions are applicable)

VIII. Computation of Tax Payable

Tax Calculation on Lottery Winnings:

Tax on Lottery Winnings:

- Lottery Winnings = Rs. 1,00,000
- Tax on Lottery = 30% of Rs. 1,00,000 = Rs. 30,000

Tax Calculation on Other Income (Business, House Property, Shop Income):

- Taxable Income (after lottery) = Rs. 3,62,260 - Rs. 1,00,000 = Rs. 2,62,260

Tax on Rs. 2,62,260:

- Up to Rs. 2.5 lakh = Nil
- Remaining Income (Rs. 12,260) taxed at 5% = 5% of Rs. 12,260 = Rs. 613

Tax Calculation Summary:

- Tax on Lottery Winnings = Rs. 30,000
- Tax on other income (Rs. 12,260) = Rs. 613
- Total Tax Before Cess = Rs. 30,000 + Rs. 613 = Rs. 30,613

IX. Education Cess and Secondary and Higher Education Cess

- Cess Rate = 4% Cess = 4% of Rs. 30,613 = Rs. 1,224.52 (rounded off to Rs. 1,225)

X. Total Tax Payable

Total Tax Payable = Rs. 30,613 + Rs. 1,225 = Rs. 31,838

For the Assessment Year 2025-26, the Total Tax Payable by the HUF is Rs. 31,838.

ILLUSTRATION II

The following particulars have been submitted by Ram Lal in the capacity of Karta of a HUF for assessment purposes:

a) Profit from families' business, Rs. 25000 after charging an amount of Rs. 60,000 given as salary to Karta's brother who has been actively participating in it.

b) Salary income of Kartas another brother who is manager in a cooperative bank Rs. 11000 p.m.

c) Directors fees received by Karta Rs. 5000(HUF holds 20% shares in this company).

d) Bank interest on fixed deposits	24000.
e) Long term capital gain from the transfer of building	28000.
f) Long term capital gain from the transfer of investment	40000.
g) Donation to a college which is an approved institution	40000.
h) Rental value of the property let	36000.
Municipal taxes paid in respect of the house	4500.
Interest on loan taken for repair of house	12000.

You are required to calculate total income and tax liability of the family for the assessment year 2025- 26.

SOLUTION:-

Computation of Total Income and Tax Liability for the HUF for the Assessment Year 2025-26

Step 1: Compute the Income under Various Heads

1. Income from House Property

Given:

- Rental Value of Property: Rs. 36,000 (Annual Rental Value)
- Municipal Taxes: Rs. 4,500
- Interest on Loan Taken for Repair of House: Rs. 12,000

Net Annual Value (NAV):

Net Annual Value=Rental Value−Municipal Taxes

NAV = Rs. 36,000 - Rs. 4,500 = Rs. 31,500

Deductions under Section 24:

1. **Standard Deduction (30% of NAV)**:

   30% of Rs. 31,500 = Rs. 9,450
2. **Interest on Loan** (Rs. 12,000 for repair of house)

   This is fully deductible under Section 24(b).

Income from House Property:

Income from House Property=NAV−Standard Deduction−Interest on Loan

Income from House Property = Rs. 31,500 - Rs. 9,450 - Rs. 12,000 = **Rs. 10,050**

2. Profit from Family Business

Given:

- **Profit from Business**: Rs. 25,000
- **Salary Paid to Brother**: Rs. 60,000 (This will be added back to the income since it is paid to a family member for services rendered.)

Business Income:

Since the salary to the brother is part of the expense already deducted from business income, we need to add back this salary.

Business Profit = Rs. 25,000 + Rs. 60,000 = **Rs. 85,000**

3. Income from Other Sources

Given:

- Bank Interest on Fixed Deposits: Rs. 24,000
- Directors' Fees: Rs. 5,000 (Since the HUF holds 20% of shares, the directors' fees are treated as the income of the HUF.)

Total Income from Other Sources:

Income from Other Sources = Rs. 24,000 + Rs. 5,000 = Rs. 29,000

4. Capital Gains

Given:

- Long-term Capital Gain from Building: Rs. 28,000
- Long-term Capital Gain from Transfer of Investment: Rs. 40,000

Total Capital Gains:

Total Capital Gains = Rs. 28,000 + Rs. 40,000 = Rs. 68,000

5. Donations

Given:

- Donation to College (Approved Institution): Rs. 40,000

This donation is eligible for a deduction under Section 80G. However, the maximum deduction allowed for donations to such institutions is restricted to 10% of the Gross Total Income (GTI).

Qualifying Amount for Deduction:

Gross Total Income = Rs. 85,000 (from business) + Rs. 10,050 (from house property) + Rs. 29,000 (from other sources) + Rs. 68,000 (capital gains) = **Rs. 1,92,050**

10% of Rs. 1,92,050 = Rs. 19,205 (This is the maximum amount that can be deducted under Section 80G).

So, Deduction under Section 80G = Rs. 19,205

Step 2: Calculate Gross Total Income (GTI)

Gross Total Income=Business Income+Income from House Property + Income from Other Sources + Capital Gains

Gross Total Income=85,000 + 10,050 + 29,000 + 68,000

=Rs. 1,92,050

Now, deduct the donation (Section 80G) from the Gross Total Income:

Total Income=Gross Total Income−Deduction under Section 80G

Total Income=1,92,050−19,205=Rs. 1,72,845

Step 3: Calculate Tax Payable

Tax on Long-term Capital Gains:

Long-term capital gains are taxed at 20%.

Tax on Long-term Capital Gains=20%×68,000=Rs. 13,600

Tax on Balance Income:

The balance income (Rs. 1,72,845) will be taxed as per the normal tax slabs for individual taxpayers.

For Assessment Year 2025-26, the tax slabs for an HUF are as follows:

- Up to Rs. 2.5 lakh: Nil
- From Rs. 2.5 lakh to Rs. 5 lakh: 5%
- From Rs. 5 lakh to Rs. 10 lakh: 20%

- Above Rs. 10 lakh: 30%

Since the total income is Rs. 1,72,845, the tax on this will be computed as:

- Tax on Rs. 1,72,845 = Nil (since it is below Rs. 2.5 lakh)

Total Tax Liability:

Total Tax Liability=Tax on Capital Gains+Tax on Balance Income Total Tax Liability=13,600+0=Rs. 13,600

Add: Education Cess (4% of tax):

Education Cess=4%×13,600 = Rs. 544

Final Tax Payable:

Tax Payable=13,600 + 544 = Rs. 14,144

Final Answer:

- Total Income: Rs. 1,72,845
- Tax Payable: Rs. 14144

15.7 LET US SUM UP

The Hindu Undivided Family system plays a significant role in the management of joint family property, inheritance, and taxation. While the concept is traditional, the laws surrounding it—particularly those governing property ownership, partition, and income—are dynamic and continue to evolve. Whether it's through the Mitakshara or Dayabhaga schools of law, the HUF structure provides a framework for both managing family wealth and fulfilling legal obligations. It is crucial for individuals, especially those managing or being part of an HUF, to understand these rights and responsibilities, as well as the tax implications. This understanding ensures not only legal compliance but also the smooth functioning and fair distribution of family assets.

CHECK THE PROGRESS

True/False:

1. A Hindu female can convert her separate property into HUF property.
   Answer: False
2. Under the Dayabhaga system, the coparceners only acquire their rights after the father's death.
   Answer: True
3. The income from the HUF property is always taxed in the hands of the HUF, not individual members.
   Answer: False
4. In a Mitakshara HUF, each coparcener has an undefined share in the joint family property.
   Answer: True

5. A partial partition of HUF property can be recognized for tax purposes even after 31st December 1978.
   Answer: False

15.8 KEYWORDS

- The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assessees.
- **'Partition'** signifies division of property. In the cases of property capable of physical division, share of each member is determined by making physical division thereof. It must be noted that a division of income without physical division of property does not amount to partition.
- Income tax has to be paid by every individual person, Hindu Undivided Family (HUF), Association of Persons (AOP), Body of Individuals (BOI), corporate firms, companies, local authorities and all other artificial juridical persons that generate income.
- **Hindu Succession Act, 1956:** This Act came into force on and from 17th June, 1956. It lays down a uniform and comprehensive system of inheritance and applies to persons governed by the Mitakshara as well as the Dayabhaga Schools, superseding and abrogating all previous law or customs or usage having the force of law.
- Where a member of a HUF is a partner in a firm on behalf of the family and on partition of the property of the family, the share in the firm is allotted to such a member, subsequent to such allotment when the firm settles its accounts the whole income for that year would be the income of the individual member and no part of the income would be added to the income of the family

15.9 SELF ASSESSMENT QUESTIONS

1. What is the significance of Section 64(2) of the Income Tax Act for HUFs?

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2. Who is entitled to a share in the partition of an HUF?

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3. What is the rule regarding the taxation of income from self-acquired property in an HUF?

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15.10 LESSON END EXERCISE

1. Explain the various steps to be followed while computing the taxable income of Hindu Undivided Family?

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2. What do you mean by Partition of a Hindu undivided family?

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3. Who is entitled to share on partition of a Hindu undivided family?

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15.11 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

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6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

UNIT – IV **B.COM 4th SEMESTER**

COURSE No. BCG-402 **LESSON No. 16**

INTRODUCTION TO FIRMS

STRUCTURE

16.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- To explain the legal definitions and structure of a partnership firm under the Income-tax Act and relevant partnership laws.
- To outline the tax treatment of firms and their partners, including rates, deductions, and disallowances under various sections.
- To examine the tax consequences of changes in the constitution of a firm, succession, or dissolution.
- To understand the process of assessment of firms and partners, and the implications of defaults or non-compliance.

Learning outcomes

- Learners will be able to explain how partnership firms and their partners are taxed under the Income-tax Act.

- Learners will be able to interpret and apply relevant sections like 184, 187, 188, and 40(b) in taxation matters involving firms.
- Learners will gain the ability to analyze and handle tax implications in situations such as reconstitution, succession, and discontinuance of a firm.
- Learners will be able to describe the rights, responsibilities, and tax liabilities of partners, including during firm transitions or closure.

16.1 INTRODUCTION

In the Indian tax system, partnership firms hold a unique position, both in terms of legal structure and taxation. Governed primarily by the Indian Partnership Act, 1932, and recognized under the Income-tax Act, 1961, firms are associations of individuals who come together with a mutual agreement to share profits from a jointly conducted business. Although a firm is not a separate legal entity distinct from its partners under general law, for taxation purposes, it is treated as an independent entity. This distinction plays a significant role in computing the firm's taxable income, determining the tax liabilities of both the firm and its partners, and applying provisions related to deductions, changes in firm constitution, succession, and dissolution. This lesson aims to provide a comprehensive understanding of how firms are taxed and the legal implications arising from various changes within their structure.

16.2 TAXATION OF FIRMS

Under Section 2(23) of the Income-tax Act, the terms "firm", "partner", and "partnership" have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

The expression "partner" also includes a minor who has been admitted to the benefits of partnership and a partner of a Limited Liability Partnership Act 2008. However a minor cannot validly enter into any partnership as a 'full partner' with other persons but he can be admitted to the benefits of partnership only.

A joint Hindu family as such cannot be a partner in a firm. However, through its Karta it may enter into a valid partnership with a third person or with a member of the undivided family in his individual capacity. In such a case, the Karta occupies a dual position. On the partnership he functions in his individual capacity; on the relations to other members of the Hindu undivided family, in his representative capacity.

An incorporated company being a legal person may form a partnership with an individual or with another company. In considering the maximum number of partners comprising a firm, the company will be considered as one person only.

A partnership firm as such is not entitled to enter into a partnership with another firm, H.U.F., individual, or a company. However, its partners in their individual capacity can enter into another partnership.

16.3 SCHEME OF TAXATION OF AFIRM AND ITS PARTNERS

Assessment as a Firm (Section 184)

As per the scheme, a partnership firm in the first assessment year shall be assessed as a firm if the following conditions are satisfied:

1. The partnership is evidenced by an instrument i.e. partnership deed.

2. The individual shares of the partners are specified in that instrument.

3. A copy of the partnership deed certified by all the partners in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.

Where the return is made after the dissolution of the firm, the copy of the partnership deed should be certified in writing by all persons (excluding minors) who were partners of the firm immediately before its dissolution and by the legal representative of any deceased partner.

When a firm is assessed as such for any assessment year, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or in the shares of partners as evidenced by the partnership deed on the basis of which assessment as a firm was first sought.

Where any such change has taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of incomefor the assessmentyear relevantto such previous year. In doing so all the provisions of Section 184 will apply to the firm.

Circumstances where the firm will be assessed as a firm but shall not be eligible for deduction on account of interest, salary, bonus, etc.

Where the firm –

(a) fails to make the return required under Section 139(1) and has not made a return or revised return under Section 139(4) or 139(5), or

(b) Fails to comply with all the terms of a notice issued under Section 142(1) or fails to comply with a direction issued under Section 142(2A), or

(c) Having made a return, fails to comply with all the terms of a notice issued under Section 143(2),

(d) Does not comply with three conditions mentioned above u/s 184.

Then the firm shall not be eligible for any deduction on account of interest to a partner and remuneration to a working partner although the same is mentioned in the partnership deed.

Rate of tax

In the case of a firm which is assessable as such (i.e. as a firm), tax is chargeable on its total income at the rate of 30%

Surcharge @10% shall be applicable where the total income exceeds ` 1 crore.

Partnership is not a separate entity distinct from the partners, but for tax purposes a partnership is taxed as a separate entity and therefore total income will be computed under various heads of income. A partnership firm is also entitled for deductions under section 30 to 37 for expenditures incurred. However, for payment of remuneration to partners and interest on capital are allowed subject to conditions laid down under section 40(b).

Section 40(b), contain the following conditions which need to be complied with while making payment of remuneration and interest on borrowed capital to the partners:

(i) Payment of salary, bonus, commission or remuneration by whatever name called to a non- working partner shall not be allowed as deduction. Such payments are allowed only to working partners if it is authorised by and is in accordance with partnership deed.

(ii) Interest payable to a partner, although authorised by the partnership deed shall be allowable as deduction subject to a maximum of 12% p.a. If the partnership deed provides for interest at less than 12% p.a, the deduction of interest shall be allowed to the extent provided by the partnership deed.

(iii) The payment of remuneration to working partner, although authorised by partnership deed however it is subject to maximum of the following limits.

Finance Act, 2009 provides for uniform limits for both professional firms and non-professional firms:	
I. 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*
II. On the balance of the book-profit	*60% of the book profits.*

Meaning of Book Profit [Explanation 3 to section 40(b)]

Book-profit" means the net profit, as shown in the profit and loss account and make the additions and deductions as per section 28 to 44D explained under the head income from Business and Profession 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. Interest paid/payable to partners in excess of 12% shall also be disallowed as per section 40(b).

CHECK THE PROGRESS

Multiple Choice Questions (MCQs)

1. Under which section of the Income-tax Act is a firm assessed for taxation purposes?

   a) Section 40(b)

   b) Section 184

   c) Section 188

   d) Section 75

   → Answer: b) Section 184

2. The maximum rate of interest allowed as deduction on capital paid to partners is:

   a) 10%

   b) 15%

   c) 12%

   d) 8%

   → Answer: c) 12%

3. When a firm is succeeded by another firm, the assessment is governed by:

   a) Section 184

   b) Section 189

   c) Section 188

   d) Section 75

   → Answer: c) Section 188

4. Remuneration is allowed as a deduction only if paid to:

   a) Sleeping partners

   b) Non-working partners

   c) Working partners

   d) Creditors

   → Answer: c) Working partners

5. A minor can:

   a) Become a full partner

   b) Only be a creditor

c) Be admitted to the benefits of partnership

d) Not be associated with a firm

→ Answer: c) Be admitted to the benefits of partnership

16.4 CHANGES IN CONSTITUTION OF A FIRM (Section 187)

Where at the time of making an assessment under Section 143 or Section 144 of the Act it is found that a change has occurred in the constitution of a firm, the assessment will be made on the firm as constituted at the time of making the assessment.

For the purposes of this section there is a change in the constitution of a firm if:

(a) One or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change (this clause, however, shall not apply to a case where the firm is dissolved on the death of any of its partners) or

(b) Where all the partners continue with a change in their respective shares or in the shares of some of them.

16.5 LOSSES OF REGISTERED FIRMS (Section 75)

Carry forward and set off of losses in case of change in constitution of firm or on succession [Section 78(1)]Where a change has occurred in the constitution of a firm on account of death or retirement, the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

Method of computation of amount not to be allowed to be carried forward

Step 1: In the year of change first ascertain the share of outgoing partner in the profit or loss of the firm.

Step 2: Compute share of loss of the outgoing partner for each of the preceding years from which the loss is carried forward.

Step 3: Amount not allowed to be carried forward: (i) Sum of [Amounts computed in Steps (1) and (2) where there is loss in the year of change]. (ii) Difference of [Amounts computed in Steps (1) and (2) in case of profit in the year of change].

ASSESSMENT OF PARTNERS

As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm will not be included in computing his total income. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.

Further, the explanation to Sub-clause (2A) provides that the share of a partner in the total income of the firm assessed as a firm shall be an amount which bears to the total income of the firm the same proportion as the amount of his share in the profits of the firm (in accordance with the partnership deed) bears to such profits.

In terms of a formula, the amount exempt would be:

Partners share in the profit of the firm =

$$\frac{\text{As shown in the partnership deed}}{\text{Total Profits of the firm}} \quad = \text{Total income of the firm}$$

Any interest, salary, bonus, commission or remuneration by whatever name called which is due to or received by a partner of a firm from the firm will be chargeable to tax in the hands of the partner under the head “profits and gains of business or profession”. However, if such salary, interest, bonus, commission or remuneration (or any part thereof) has not been allowed as deduction as per Section 40(b) in the hands of the firm, the amount not allowed as deduction shall not be charged to tax in the hands of partners.

Further, deductions under Sections 32 to 37 can be claimed by a partner from any income where any expenditure was incurred to earn such income.

CHECK THE PROGRESS

True / False

1. A partnership firm is treated as a separate legal entity under general law.
   → False
2. Interest paid to partners above 12% per annum is fully deductible.
   → False
3. The successor firm is jointly liable to pay tax dues of the predecessor firm.
   → True
4. The dissolution of a firm means it ceases to exist for tax assessment purposes.
   → False

5. The share of profit received by a partner from a firm is exempt in his hands.
   → True

16.6 SUCCESSIN OF ONE FIRM BY ANOTHER FIRM (Section 188)

When all the partners in the predecessor firm are replaced by new partners in the successor firm, it is known as succession of one firm by another firm. If a firm is dissolved and some of the partners take over the firm's business or carry on a similar business with or without new partners, it would be a case of succession by a new firm (62 I.T.R. 75).

In CIT v. K.H. Chambers (1965) 55 ITR 674, the Supreme Court laid down the following requisites of succession:

(i) There is a change of ownership.

(ii) The whole business is transferred.

(iii) Substantially the identity and the continuity of the business are preserved.

Where the partnership deed does not provide specifically for continuance of the firm on the death of a partner, there would be no change in constitution of the firm but it would be a case of succession. [*Addl. CIT v. ThyagasundaraMudaliar* (1981) 127 ITR 520].

Where a firm is succeeded by another firm, separate assessments are made on the predecessor and successor firms respectively in accordance with the provisions of Section 170 which provides that the predecessor shall be assessed in respect of the income of the previous year in which the succession took place up to the date of succession and the successor shall be assessed in respect of the income of the previous year after the date of succession. If the predecessor cannot be found, or the tax assessed on the predecessor cannot be recovered from him for the previous year (in which the succession took place) and the previous year immediately preceding such previous year, the unrealised tax payable by the predecessor shall be recovered from the successor.

However, the successor firm is entitled to recover from the predecessor firm any tax paid by it on behalf of the former. If any tax is due against any partner of the predecessor firm, it cannot be recovered from the successor firm.

Joint and several liability of partners for tax payable by firm (Section 188A)

As per this section every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of Income-tax Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

Firm Dissolved or Business Discontinued (Section 189)

Where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the assessment of the total income of the firm shall be made as if no such discontinuance or dissolution had taken place and all the provisions of the Act, including the provisions relating to penalty or any other sum (interest, fine) chargeable under the Act, shall apply. Consequently, every person who was a partner of the firm at the time of discontinuance of business or dissolution of the firm and legal representative of the deceased partner shall be jointly and severally liable to the amount of tax penalty and any other sum. Where the dissolution or discontinuance of business takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the partners or legal representative of a deceased partner from the stage at which the proceedings stood at the time of such dissolution or discontinuance. Thus, every partner of the firm and the legal representative of the deceased partner is liable to pay the tax which is already due or may have become due after the dissolution, irrespective of his interest in the firm. However, if there was any irrecoverable amount at the time of dissolution or discontinuance of business and later on it was recovered by the partners, the partners shall personally pay the tax on their share so recovered.

16.7 LET US SUM UP

The taxation of firms involves a detailed understanding of the interplay between partnership law and tax regulations. While firms are taxed as separate entities, the income distribution and responsibilities of partners remain closely linked to the firm’s financial and legal status. Key provisions such as **Sections 184, 40(b), 187, 188, and 189** guide the assessment, deductions, and liabilities in different scenarios, including reconstitution, succession, and dissolution. Understanding these provisions ensures accurate tax compliance and prevents potential legal issues for both firms and partners. As businesses evolve and partnership structures change, staying informed about these tax rules is crucial for financial planning and legal integrity.

CHECK THE PROGRESS

One-Word

1. Section that governs assessment of firm:
   → Section 184
2. Maximum interest rate allowed on partner's capital:
   → 12% per annum
3. Document required for firm registration and assessment:
   → Partnership Deed
4. Head under which partner's remuneration is taxed:
   → Profits and Gains of Business or Profession
5. Section related to change in firm's constitution:
   → Section 187

16.8 KEYWORDS

Partnership Firm: Under Section 2(23) of the Income-tax Act, the terms "firm", "partner", and "partnership" have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

Partner – An individual who joins in an agreement to operate a firm and share its profits and losses.

Partnership Deed – A legal document that outlines the terms and conditions of a partnership.

Working Partner – A partner who actively participates in the daily operations of the firm.

Book Profit – Net profit as per the profit and loss account, adjusted as per income tax provisions.

Section 184 – Deals with conditions under which a firm is assessed as a partnership firm.

Section 40(b) – Specifies the limits and conditions for allowing deductions of interest and remuneration to partners.

Section 187 – Refers to a change in the constitution of a firm (e.g., admission or retirement of a partner).

Section 188 – Deals with succession of one firm by another and related tax implications.

Section 189 – Relates to the tax assessment of a firm upon dissolution or discontinuance of business.

Remuneration – Salary, bonus, or commission paid to working partners, allowable under certain conditions.

Interest on Capital – Interest paid to partners on their capital contribution, subject to a 12% maximum limit.

Share of Profit – The exempt portion of income received by a partner from a firm assessed as a firm.

Dissolution – The legal ending of a firm's existence and business operations.

Succession – The transfer of business from one firm to another, resulting in a new tax entity.

16.9 SELF ASSESSMENT QUESTIONS

1. What do you mean by Firm?

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2. Explain the difference between the change in constitution and succession of a firm. Illustrate.

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3. Describe the tax treatment of a partner's share in the firm's income.

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16.10 LESSON END EXERCISE

1. What are the conditions under Section 184 for a firm to be assessed as a partnership firm?

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2. Explain the disallowances under Section 40(b) related to payments made to partners.

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3. How is the tax liability distributed when one firm is succeeded by another?

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16.11 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; Pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

ASSESSMENT OF FIRMS

STRUCTURE

17.0 Learning Objectives and Learning Outcomes

17.1 Introduction

17.2 Computation of income on estimated basis in case, taxpayers are engaged in certain business

17.3 Other Provisions relating to Limited Liability Partnership

17.4 Alternate Minimum Tax (AMT) (Section 115JC)

17.5 Practical Problem

17.6 Let Us Sum Up

17.7 Keywords

17.8 Self Assessment Questions

17.9 Lesson End Exercise

17.10 Suggested Readings

17.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand the provisions related to the computation of income on an estimated basis for small businesses under Section 44AD and how it applies to different types of assessees including firms.
- Learn the taxation norms and special provisions applicable to Limited Liability Partnerships (LLPs), including conversion rules, depreciation, and carry forward of losses.
- Gain knowledge of Alternate Minimum Tax (AMT) under Section 115JC, its applicability to non-corporate taxpayers, and the concept of adjusted total income.
- Apply theoretical knowledge to practical scenarios involving income computation, partner remuneration, interest, and other allowable/disallowable expenses through case studies and illustrations.

Learning outcomes

- Calculate total income and tax liability of a partnership firm or LLP as per the relevant sections of the

Income Tax Act.

- Distinguish between eligible and non-eligible businesses for presumptive taxation and apply the correct rate of estimation under Section 44AD.
- Evaluate the tax implications of LLP conversions and handle associated adjustments like depreciation, MAT credit, and carry forward of losses.
- Solve practical problems and compute taxable income using real-life partnership firm scenarios, correctly applying sections 40(b), 44AD, 115JC, and 185.

17.1 INTRODUCTION

The assessment of partnership firms under the Income Tax Act, 1961, is a specialized area that takes into account the distinct legal and operational structure of such entities. Partnership firms and Limited Liability Partnerships (LLPs) are separate legal entities for tax purposes and are assessed independently of their partners. The tax treatment involves detailed rules regarding the computation of business income, allowance of remuneration and interest to partners under Section 40(b), and eligibility for presumptive taxation under Section 44AD. Additionally, LLPs are subject to provisions like Alternate Minimum Tax (AMT) under Section 115JC. Understanding these provisions is crucial for ensuring compliance and optimizing tax liability. This lesson provides an in-depth look into how firms and LLPs are assessed, covering both regular and special provisions through explanations, legal references, and practical illustrations.

17.2 COMPUTATION OF INCOME ON ESTIMATED BASIS IN CASE TAX PAYERS ARE ENGAGED IN CERTAIN BUSINESS (Section 44AD)

An assessee being an individual, a resident HUF or a partnership firm (not being a LLP), who has not claimed any deduction under Sections 10A, 10AA, 10B, 10BA, 80HH to 80 RRB in the relevant assessment year is eligible to pay tax on estimated basis.

Further, the assessee should be engaged in any business (whether it is retail trading or wholesale trading or civil construction or any other business). The turnover/gross receipt of the eligible business shoud not exceed `1 crore during the previous year.

The following persons are not eligible to avail benefit under Section 44AD:

(a) a person carrying on profession as referred to in Section 44AA(1) or

(b) a person earning income in the nature of commission or brokerage or

(c) aprson carrying on any agency business or

(d) a person who is in the business of plying, hiring or leasing goods carriages.

If the above conditions are satisfied, the income from eligible business is estimated @ 8% of gross receipt or total turnover. Further, it is assumed that all the deductions have been allowed and no other deduction is allowed.

However, in case of firm, the normal deduction in respect of salary and interest to partners under Section 40(b) shall be allowed.

CHECK THE PROGRESS

Multiple Choice Questions (MCQs)

1. Under Section 44AD, income is presumed to be ______ of the turnover or gross receipts.

   a) 5%

   b) 6%

   c) 8%

   d) 10%

   Answer: c) 8%

2. Which of the following is **not eligible** for presumptive taxation under Section 44AD?

   a) Retail traders

   b) Partnership firms (non-LLP)

   c) Doctors

   d) Construction contractors

   Answer: c) Doctors

3. Alternate Minimum Tax (AMT) is applicable to:

   a) Companies only

   b) All individuals

   c) LLPs and other non-corporate taxpayers claiming deductions

   d) Government organizations

   Answer: c) LLPs and other non-corporate taxpayers claiming deductions

4. The allowable interest to partners under Section 40(b) must not exceed:

   a) 10% per annum

   b) 12% per annum

c) 15% per annum

d) No limit

Answer: b) 12% per annum

5. The share of profit received by a partner from a firm is:

   a) Fully taxable

   b) Partly exempt

   c) Fully exempt under Section 10(2A)

   d) Deductible as expense

   Answer: c) Fully exempt under Section 10(2A)

17.3 OTHER PROVISIONS RELATING TO LIMITED LIABILITY PARTNERSHIP:

(1) Transfer of capital asset or intangible asset by a private Limited company or a non-listed company to Limited Liability Partnership and correspondingly any transfer of a share or shares held in a company by a shareholder shall not be treated as transfer:

Any transfer of a capital asset or intangible asset by a private company or unlisted public company (hereafter in this clause referred to as the company) to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership in accordance with the provisions of section 56 or section 57 of the Limited Liability Partnership Act, 2008 shall not treated as transfer for the purpose of capital gain under section 45 subject to the following conditions:

(a) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;

(b) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion;

(c) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership;

(d) the aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion;

(e) the total sales, turnover or gross receipts in the business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees; and

(f) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

(2) Consequential amendments due to conversion of a private limited company or a non-listed company into LLP:

(i) Allowability of depreciation: Aggregate deduction, in respect of depreciation of buildings, machinery, plant or furniture, being tangible assets or know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets allowable to the predecessor and the successor in the case of succession of company into LLP, shall not exceed in any previous year the deduction calculated at the prescribed rates as if the succession, had not taken place.

(ii) **Successor LLP will be allowed deduction of payment under Voluntary Retirement Scheme for the unexpired period:** Where a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, the provisions of this section shall, as far as may be, apply to the successor limited liability partnership, as they would have applied to the said company, if reorganisation of business had not taken place.]

(iii) Cost of Acquisition of the asset in case the predecessor company has claimed deduction under section 35AD shall be taken to be nil in the hands of LLP.

(iv) Actual cost of the block of the asset in the hand of successor LLP: Where in any previous year, any block of assets is transferred by a private company or unlisted public company to a limited liability partnership and the conditions specified in the proviso to clause (xiiib) of section 47 are satisfied, then, notwithstanding anything contained in clause (1), the actual cost of the block of assets in the case of the limited liability partnership shall be the written down value of the block of assets as in the case of the said company on the date of conversion of the company into the limited liability partnership.

(v) Carry Forward and set off of losses (Section 72A(6A): Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

However, if any of the conditions laid down in the proviso to clause (xiiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

"Accumulated loss" means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

"Unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

(vi) MAT credit of the predecessor company will lapse.

17.4 ALTERNATE MINIMUM TAX (AMT) (Section 115JC)

Where the regular income tax payable for a previous year by a person other than a company is less than the alternate minimum tax payable for such previous year then the adjusted total income shall deemed to be the total income of that person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus education & SHEC @ 3%.

Upto Assessment Year 2012-13, Alternate Minimum Tax (AMT) is levied on limited liability partnerships (LLPs). However, no such tax is levied on the other form of business organisations such as partnership firms, sole proprietorship, association of persons, etc.

In order to widen the tax base vis-à-vis profit linked deductions, the provisions regarding AMT has been broaden to cover all persons other than a company, who has claimed deduction under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" or under section 10AA, shall be liable to pay AMT.

Accordingly, where the regular income-tax payable for a previous year by a person (other than a company) is less than the alternate minimum tax payable for such previous year, the adjusted total income shall be deemed to be the total income of such person and he shall be liable to pay income-tax on such total income at the rate of eighteen and one-half per cent.

For the purpose of the above,

(i) "adjusted total income" shall be the total income before giving effect to provisions of Chapter XII-BA as increased by the deductions claimed under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" and deduction claimed under section 10AA;

(ii) "alternate minimum tax:" shall be the amount of tax computed on adjusted total income at a rate of eighteen and one half per cent; and

(iii) "regular income-tax" shall be the income-tax payable for a previous year by a person other than a company on his total income in accordance with the provisions of the Act other than the provisions of Chapter XII-BA.

It is further provided that the provisions of AMT under Chapter XII-BA shall not apply to an individual or a Hindu undivided family or an association of persons or a body of individuals (whether incorporated or not) or an artificial juridical person referred to in section 2(31)(vii) if the adjusted total income of such person does not exceed twenty lakh rupees.

It is also provided that the credit for tax (tax credit) paid by a person on account of AMT under Chapter XIIBA shall be allowed to the extent of the excess of the AMT paid over the regular income-tax. This tax credit shall be allowed to be carried forward up to the tenth assessment year immediately succeeding the assessment year for which such credit becomes allowable. It shall be allowed to be set off for an assessment year in which the regular income-tax exceeds the AMT to the extent of the excess of the regular income-tax over the AMT.

Every person to which this section applies shall obtain a report, in such form as may be prescribed from an accountant certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report on or before the due date of filing of return under sub-section (1) of section 139.

CHECK THE PROGRESS

True or False

1. LLPs are allowed to pay remuneration to partners under Section 40(b).
   False
2. Presumptive taxation under Section 44AD can be availed by an individual engaged in a profession.
   False
3. Alternate Minimum Tax applies to individuals only if their adjusted total income exceeds ₹20 lakhs.
   True
4. Conversion of a private limited company to LLP is always considered a transfer under capital gains.
   False
5. Interest received from bank deposits by a firm is taxable under "Income from Other Sources."
   True

17.5 PRACTICAL PROBLEM

A) PARTNERSHIP FIRM/LLP ASSESSED U/S 184.

ILLUSTRATION I

A and B are active partners and C and D are sleeping partners in a firm. A profit and loss account, drawn for the year ending 31-3-2024 shows a profit of rs. 25000. The Profit has been arrived at after allowing salary and interest to partners as follows:

	A	B	C	D
Salary	25000	23000	—	—
Interest @ 9%	2000	4000	6000	3000

Further the long term capital gains of the firm are Rs. 40000.Partners share the profit and loss equally. Compute the total income of the firm and its tax liability. Interest to all the partners and salary to working partners has been paid as per deed.

SOLUTION:

Rs.Rs.

Net profit as per profit and loss A/C 25000

Add: Disallowed deductions:

Salary to partners

A 25000

B 23000

Interest to partners is less than 12%& hence allowed 48000

Book Profit 73000

Less: allowable remuneration to partner's u/s 40

(b) Since salary etc. given to all partners is less than

Rs. 150000 hence allowed in full 48000

Business profit Capital gain: 25000

Long term capital gain

40000

G.T.I & Total Income 65000

Tax liability of the firm

On long term capital gain of Rs 40000 @ 20% 8000

On balance income (65000-40000 = 25000) @30% 7500

Tax

15,500

Add: Education cess @ 4% of tax 620

Tax Payable 16120

ILLUSTRATION II

Profit and Loss Account of ABC and Co. (a firm of chartered accountants) for the year ending 31-3-/2024 is as follows:

	Rs.		Rs.
Expenses	10000	Receipts from clients	135000
Depreciation	75000	Bank interest	25000
Remuneration to working partners	80000	Net Loss	42500

Interest on capital to partners@ 20% 37500

202500 202500

Other information:

i) Out of expenses of Rs. 10000, Rs. 6400 is notdeductible by virtue of section 36 and 37.

ii) Depreciation as per section 32 is Rs. 27500.

Find out the amount of net income of the firm for the assessment year 2021-22. The remuneration and interest on capital to partners have been paid according to partnership deed which has been submitted along with return.

SOLUTION:

Computation of Firms Total Income	**Rs.**	**Rs.**
Professional receipts		135000
Less: Professional expenses		
Allowable Expenses (10000-6400)	3600	
Allowable depreciation	27500	
Interest on capial (37500x 12/20)	22500	53600
Book Profit	81400	
Less: Allowable remuneration u/s 40(b)		
Actual Remuneration	80000	
Or		
90% of Book Profit of Rs. 81400	73260	
Whichever is more is allowed		80000
Taxable Business profit		1400
Add: Income from other sources		
Bank Interest		25000
Firms total Income		**26400**

ILLUSTRATION III

The doctors Dr. Ahalya and Somnathare running a nursing home under a partnership firm profits and losses equally and showed Rs. 16600 as profit for the previous year 2024-25 after charging the following:

Operation charges to Dr. Somnath(100 per operation)	*1500*
Remuneration to Dr. Ahalya	*6200*
Honorarium to Dr. Somnath	*3000*
Bonus to Each Doctor	*2000*

Donation to shelter for Hindus	*3750*
Interest on Capital to each Doctor@9%	*2000*
Purchase of surgical equipment	*12500*
House property rent	*9600*
Bank Interest	*4000*

Compute firms' total income and find out the income of partners taxable under the head profit and gains. Firm's deed provides for payment of operation charges, remuneration, bonus, honorarium and interest on capital.

SOLUTION

Computation of Firms Professional Gain	**Rs**	**Rs**
Net profit as per P&L A/C		16600
Add: *Disallowed expenses*		
Operation charges to Dr. Somnath	1500	
Remuneration to Dr. Ahalya	6200	
Honorarium to Dr. Somnath	3000	
Bonus to each doctor	4000	
Donation to shelter for Hindus3750		
Cost of surgical equipment	12500	30950
47550		
Less:*Allowable expenses*		
Depreciation (12500 @ 15%)		1875
		45675
Less: Income not taxable under this head		
Rent from House property	9600	
Bank interest	4000	13600
Book Profit32075		
Less: *Allowable remuneration/s 40(b)*		
Operation charges to Dr. Somnath	1500	
Honorarium to Dr. Somnath	3000	
Remuneration to Dr. Ahalya	6200	
Bonus to each Doctor(2000)	4000	14700
Professional gain	17375	

Computation of Firms Total Income

House Property: ARV		9600	
Less: M.Taxes	Nil		
N.A.V	9600		
Standard deduction: 30% of NAV		2880	6270
Profits and Gains: Professional gain			17375
Other sources: Bank interest			4000
Total Income			28095

Rounded off to Rs. 28100

Firms Tax: 30% of 28100=Rs. 8430 + Edu. cess@3 % i.e. Rs.253= Rs 8683, rounded off to 8680

Partners Professional Income

1. Dr Ahalya:	Remuneration		6200
Bonus		2000	
Interest on Capital		2000	
			10200
2. Dr Somnath:	Operation Charges		1500
	Honorarium		3000
	Interest on Capital		2000
	Bonus		2000
			8500

Notes: 1.share of income from Firm is fully exempted u/s 10(2A) in the hands of partners.

2.Operating charges, remuneration, honorarium and bonus paid to partners are fully allowed as they are within limits.

B) ASSESSMENT OF FIRM/LLP U/S 185.

ILLUSTRATION I

Asim, john and Rahim are partners in a firm assessed as u/s 185 sharing profits and losses in the ratio of 5:3:2. Profit and loss account for the year ending on 31-3-2024 was as follows:

Profit & Loss

To rent and taxes	6000	By Gross Profit	40000
To salaries	9000	By Interest on securities	3000
To electric charges	1200		
To interest on capital			

Asim	2000		
John	1500		
Rahim	1000		
To Depreciation	2500		
To Reserve for bad debts	500		
To interest on loan from John	300		
To commission to Rahim	1000		
To Balance:			
Asim	9000		
John	5400		
Rahim	3600		
	43000		43000

Note:*1. Salary includes Rs. 2000 paid to Rahim*

2. Depreciation allowable amount to Rs. 2400

Compute the Business Income for Firm as AOP and U/s 185.

SOLUTION

Computation of business income of the form assessed u/s 185

Profit as per P/L A/c		18000
Add: expenses charged but not allowed:		
Interest on capital		
Asim	2000	
John	1500	
Rahim	1000	4500
		22500
Depreciation	2500	
Reserve for Bad debts	500	
Interest on loan from John	300	
Commission to Rahim	1000	
Salary to Rahim	2000	6300
		28800

Less: **Income credited but to be treated under a separate head:**	
Income from other sources: Interest on Securities	3000
	25800
Less: **Allowable business expenses**	
Depreciation	2400
Business Income of Firm	**23400**

ILLUSTRATION II

PQR and Co. A partnership firm with three partners P, Q and R sharing profits and losses in the ratio of 3:2:1, gives the following particulars of its profit and loss account for the year ending on 31st March 2024:

a) Profit as per profit and loss account, Rs 50000

b) Drawings debited to profit and loss account Rs. 40000

c) Depreciation debited 75000.actually admissible 90000.

d) Entertainment expenses 10000

e) Bad debts recovered and credited to P/L A/c-15000.This is recovery out of a debt of 40000 written off as bad in 2019-20 of which only Rs 30000 was allowed in the relevant assessment.

f) Salaries paid to Q. Rs 12000

g) Commission paid to R. Rs 20000

Compute the total income of the firm as u/s 18. Each item of information above should be fully dealt with in your answer.

SOLUTION

Computation of Firms Total Income assessed u/s 185

	Rs	Rs
Profit as per P/L A/c		50000
Add: **Disallowed items**		
Drawings	40000	
Depreciation	75000	
Salaries to Q	12000	

Commission to R	20000	147000
		197000
Less: **Incomes not taxable under the head**		
Bad debts recovered ----Disallowed earlier		
(40000-30000=10000) being exempted	10000	
		187000
Less: **Expenses allowed but not debited**		
Depreciation90000		
Firms Total Income		**97000**

CHECK THE PROGRESS

Fill in the Blanks

1. Under Section 44AD, presumptive income is calculated at ___% of gross receipts.
   8
2. The provisions of AMT are contained in Section ______ of the Income Tax Act.
   115JC
3. The remuneration and interest paid to partners must be authorized by the ________.
   Partnership Deed
4. A firm assessed under Section 185 does not get deduction for _______ paid to partners.
   Remuneration
5. Losses and unabsorbed depreciation of a company converting into LLP can be carried forward if conditions under Section ____ are satisfied.
   47(xiiib)

17.6 LET US SUM UP

In conclusion, the assessment of firms under the Income Tax Act requires a thorough understanding of the legal provisions that distinguish firms from other forms of business organizations. Key takeaways include the eligibility for presumptive taxation under Section

44AD, the disallowance and allowance of specific expenditures like partner remuneration and interest, and the special provisions applicable to LLPs, especially during and after conversion. The concept of Alternate Minimum Tax ensures that firms claiming significant deductions still contribute a minimum amount of tax. By applying these principles and calculations through various illustrations, one gains practical insights into real-world tax computation. A clear grasp of these rules not only helps in accurate tax filing but also aids in strategic tax planning for partnership firms and LLPs.

17.7 KEYWORDS

- **Assessment:** It refers to the process of determining the total income and tax liability of a taxpayer by the Income Tax Department based on the return filed or through scrutiny.
- **Firm:** A firm is a business entity formed by two or more persons who come together with an agreement to share the profits and losses of the business. It is assessed separately under the Income Tax Act.
- **Limited Liability Partnership (LLP):** LLP is a hybrid business structure that combines the features of a partnership and a company. In an LLP, the liability of each partner is limited to the extent of their contribution.
- Presumptive Taxation (Section 44AD): This is a simplified taxation scheme available to small businesses, where the income is presumed to be a fixed percentage of turnover, and no detailed books of accounts are required.
- **Section 40(b):** This section specifies the conditions and limits under which remuneration and interest paid to partners are allowed as deductions from the firm's income.
- **Alternate Minimum Tax (AMT):** AMT is a minimum tax liability imposed on entities (other than companies) who claim significant deductions, ensuring that they pay a minimum amount of tax.
- **Book Profit**: Book profit is the net profit of the firm as shown in the profit and loss account, after making necessary adjustments for allowable and disallowable items as per tax laws.

- **Remuneration to Partners:** This refers to the salary, commission, bonus, or other payments made to working partners of the firm. These are allowed as deductions only if they are within the limits specified in Section 40(b).
- **Interest on Capital:** This is the interest paid to partners on their capital investment in the firm. It is deductible only if it does not exceed the prescribed rate (currently 12% per annum).
- **Conversion to LLP:** This is the legal process through which a private or unlisted public company is converted into a Limited Liability Partnership as per the provisions of the LLP Act, 2008.

17.8 SELF ASSESSMENT QUESTIONS

1. Explain in brief the condition for allow ability of deduction of interest to a partner?

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2. What is the New Scheme of Taxation of a firm?

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....

....

3. What is the treatment of remuneration and interest paid to partners under Section 40(b)?

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17.9 LESSON END EXERCISE

1. What are the tax implications when a private company is converted into an LLP?

....

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………

2. Explain Alternate Minimum Tax (AMT)**?**

………

………

………

3. Explain Scheme of taxation of a firm and its partners?

………

………

………

17.10 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; Pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

INTODUCTION TO ASSOCIATION OF PERSONS

STRUCTURE

18.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand the meaning and concept of Association of Persons (AOP) under the Income Tax Act.
- Learn how an AOP is formed, including important legal cases that help define it.
- Know the tax rules and treatment for income earned by an AOP.
- Identify the differences between AOPs and other types of entities like individuals or firms

Learning outcomes

- Clearly explain what an Association of Persons is and how it works.
- Describe the conditions required to treat a group as an AOP for tax purposes.
- Apply the correct tax rules when calculating income and deductions for an AOP.

- Recognize when interest or salary paid to members of an AOP is not allowed as a tax deduction.

18.1 INTRODUCTION

In income tax law, not just individuals and companies are taxed — even a group of people who come together to earn income can be taxed. This group is called an Association of Persons (AOP). The Income-tax Act does not directly define the term, but courts have explained that when two or more people join hands for a common goal of earning income, they can be considered an AOP. Such a group can include individuals, firms, companies, or even minors (through guardians). Understanding what qualifies as an AOP, how it is formed, and how it is taxed is important to correctly assess the income and tax liabilities under the law.

18.2 ASSOCIATION OF PERSONS

'Association of persons' has not been defined in the Income-tax Act. However in the case of CIT v. Indira Balkrishna [(1960) 39 ITR 546] the Supreme Court has defined it as:

"Association of persons" means an association in which two or more persons join in for a common purpose or common action to produce income, profits or gains".

An association of persons may consist of non-individuals (Companies, firms joint families) [Ipoth v. CIT (1968) 67 ITR 106 (S.C.)]. A minor can join an AOP if his lawful guardian gives his consent. [Murugesan& Bros. v. CIT (1973) 88 ITR 432 (SC)].

Applying the ratio laid down by the Supreme Court in the case of G. Murugesan and Bros. v. Commissioner of Income-tax (1973, 88 ITR 432), the Kerala High Court held in the case of Commissioner of Income-tax v. Goel C. Dalal and Perin C. Dalal (1990, 184 ITR 248) that in order to acquire the status of an association of persons, the persons must join in a common purpose or action and the object of the association must be to produce income. It is not enough that the persons receive the income jointly.

CHECK THE PROGRESS

True / False

1. AOP can be formed by two or more people for a common purpose.
   → True
2. A minor can never be a member of an AOP.
   → False
3. Interest paid by an AOP to a member is allowed as a deduction.
   → False
4. AOP can include companies and firms as members.
   → True
5. Members of an AOP must always have equal shares.
   → False

18.3 FORMATION OF AN ASSOCIATION OF PERSONS

For the formation of an AOP the association need not necessarily be on the basis of a contract, consent and understanding may be presumed [Shanmugham& Co. v. CIT (1971) 81 ITR 310 (S.C.)].

Applying the ratio laid down by the Supreme Court in the case of N.V. Shanmugham& Co. v. Commissioner of Income-tax (1971, 81 ITR 310) the Calcutta High Court held in the case of Gopal Chand Sen v. Income-tax Officer and others (1977, 109 ITR 820) that an assessment of business income has to be done in the hands of receivers and in such an assessment, the receivers are never assessed as independent earners of income. The income in the hands of the receiver is assessable in the like manner and to the same extent as it would have been assessed on the real owners.

However, co-owners, co-heirs or co-legatees do not constitute an AOP in respect of the income of the joint or common asset by reason only of their jural relationship. But if they write themselves with the objective of earning income they constitute an AOP for assessment purposes. [Estate of Mohamed Rowther v. CIT (1963, 49 ITR 39)]. Section 26 of the Income-tax Act provides that where property consisting of building or buildings and lands appurtenant thereto is owned by two or more persons in definite and ascertainable shares, such persons shall not, in respect of such property be assessed as an AOP, but on their respective share of income therefrom.

In order to constitute an association of persons, there must be joining together in a common purpose or in a common action, the object of which is to produce income, profits and gains. Though a body of individuals is not identical with an association of persons, they have some similarities. An association of persons may consist of non-individuals also but a body of individuals has to consist only

of human beings. The word ‘body’ would require an association for some common purpose or for a common cause or there must be unity under some common tie or occupation. A mere collection of individuals without a common tie or common aid cannot be taken to be a body of individuals failing under Section 2(31) of the Income-tax Act, 1961. [See CIT v. Deghamwala Estates (1980, 121 ITR 684)].

18.4 TAX LIABILITY OF ASSOCIATION OF PERSONS

With effect from assessment year 1989-90, the following provisions are applicable to assessees other than companies, co-operative societies and societies registered under the Societies Registration Act, 1860 or any law corresponding to that Act in force in any part of India.

(1) Interest paid by the AOP to a member will not be allowed as a deduction from the income of the Association of Persons [Section 40(ba)]. In cases where interest is paid by the AOP to any member, who has also paid interest to the AOP, the net amount of interest that will be disallowed is the amount of interest paid by the AOP to the member less the amount of interest paid to the AOP by the member [Explanation 1 to Section 40(ba)].

(2) In cases where an individual is a member of an AOP in a representative capacity, any interest paid by the AOP to such individual or by such individual to the AOP, otherwise than in a representative capacity will not be subject to disallowance under explanation 2(i) to Section 40(ba).

(3) In the cases of interest paid by AOP to such individual or by such individual to the AOP in a representative capacity any interest paid by the AOP to the person represented by

such person or vice versa, will not be allowed under Section 40(ba) [Explanation 2(ii) to Section 40(ba)].

(4) Explanation 3 to Section 40(ba) further provides that where an individual is a member of the AOP otherwise than as member in a representative capacity, any interest paid by the AOP to such individual will not be disallowed if the interest is received by him on behalf of any other person.

(5) Any salary, bonus, commission or remuneration (by whatever name called) paid by the AOP to a member will not be allowed as a deduction.

Section 167B makes the following provisions as regards the incidence of charge of tax on the association of persons.

A. Where shares of members are determinate

In this case, tax is chargeable on the income of the association of persons at the same rate as applicable to an individual. However, where the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate of 30%, i.e. the highest slab applicable to an individual. More so, where the total income of any member of the AOP, irrespective of whether or not it exceeds the maximum amount not chargeable to tax in the case of an individual, is chargeable to tax at a rate higher than the maximum marginal rate, tax will be charged on the total income of the AOP at such higher rate.

B. Where the shares of the members are indeterminate

In these cases, tax will be charged on the total income of the AOP at the maximum marginal rate, that is, the rate of tax as well as surcharge, if any, applicable to the highest slab of income in the case of an individual as specified in the Finance Act of the relevant year. The individual shares of the members in the whole or any part of the income of the AOP will be deemed to be indeterminate or unknown if such shares are indeterminate or unknown on the date of formation of the AOP, or at any time thereafter.

CHECK THE PROGRESS

Multiple Choice Questions (MCQs)

1. What is the main reason for forming an AOP?

   a) To save tax

   b) To work on social issues

   c) To earn income or profit together

   d) To form a partnership

   → c) To earn income or profit together

2. Which section of the Income Tax Act deals with tax rates for AOPs?

   a) Section 26

   b) Section 40(ba)

   c) Section 167B

   d) Section 80C

   → c) Section 167B

3. What is the tax rate applied if members' shares in an AOP are indeterminate?

   a) 10%

   b) Normal rate

   c) Maximum marginal rate

   d) No tax

   → c) Maximum marginal rate

4. Can an AOP include non-individuals like companies?

   a) Yes

   b) No

   → a) Yes

5. What is not allowed as a deduction from AOP income?

   a) Rent

   b) Salary to member

   c) Electricity bill

   d) Depreciation

   → b) Salary to member

18.5 LET US SUM UP

An Association of Persons (AOP) is formed when two or more persons voluntarily come together to carry out a common purpose to earn income. It is not necessary for them to sign a formal contract — even an informal agreement can lead to the formation of an AOP. The tax treatment of an AOP depends on whether the shares of its members are known or not. Interest and salary paid to members may be disallowed under specific conditions. Understanding the rules related to AOPs helps in correctly applying tax laws and avoiding disputes with the tax department.

CHECK THE PROGRESS

One-word Questions

1. What is the full form of AOP?
   → **Association of Persons**
2. Who defines AOP in the absence of a definition in the Act?
   → **Court (Judiciary)**
3. What is charged when members' income share is unknown?
   → **Maximum marginal rate**
4. What type of persons can form an AOP?
   → **Individuals and Non-individuals**
5. Who is not assessed as an AOP automatically — co-owners or business partners?
   → **Co-owners**

18.6 KEYWORDS

- **Association of Persons (AOP)**
  A group of two or more people who come together for a common goal — usually to earn income or profit.
- **Body of Individuals (BOI)**

A group of individuals who work together for a common purpose but are not necessarily in a formal association.

- **Representative Capacity**
  When someone acts on behalf of another person or group (e.g., a guardian representing a minor).
- **Tax Liability**
  The amount of tax that an individual, group, or organization is legally required to pay.
- **Maximum Marginal Rate (MMR)**
  The highest rate of income tax applicable to individuals, often used when shares of AOP members are unknown.
- **Indeterminate Shares**
  When the exact share of income belonging to each member of an AOP is not fixed or known.
- **Definite Shares**
  When the share of profit or income for each member of the AOP is clearly known and defined.
- **Disallowance**
  An expense that is not allowed as a deduction while calculating taxable income (e.g., salary paid to members of an AOP).
- **Common Purpose**
  A shared goal or objective, such as doing business or earning income jointly.
- **Income-tax Act, 1961**
  The main law in India that governs income tax, including rules for AOPs and other taxpayers.

18.7 SELF ASSESSMENT QUESTIONS

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1. Name two things not allowed as deductions from AOP income.

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2. Can a minor become a member of an AOP?

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....

3. How is an AOP different from a Body of Individuals (BOI)?

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18.8 LESSON END EXERCISE

1. What is meant by Association of Persons? How is it formed?

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2. What is the tax treatment if the shares of AOP members are not known?

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....

3. Discuss tax liability of an Association of Persons?

....

....

....

18.9 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan

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7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

ASSESSMENT OF ASSOCIATION OF PERSONS

STRUCTURE

19.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand how the income of an Association of Persons (AOP) is shared among its members.
- Learn the method of calculating tax when the shares of members are known or unknown.
- Know the rules about how a member's share is taxed under Section 86.
- Understand how AOPs are assessed after dissolution and during practical tax situations.

Learning outcomes

- Calculate the share of income for each member of an AOP using Section 67A.
- Identify when AOP income is taxed at the maximum marginal rate under Section 167B.
- Explain how a member's income is treated for tax under different situations as per Section 86.

- Solve practical problems involving AOP tax assessment and understand tax treatment after its closure or dissolution

19.1 INTRODUCTION

An Association of Persons (AOP) is a group of individuals who come together for a common purpose and share profits and losses. In taxation, the income of an AOP is assessed differently than that of individuals or companies. The Income Tax Act provides specific rules on how to compute the share of each member in the income of the AOP, how the income should be taxed, and what happens when the shares of members are not clearly known. Understanding these rules is important for proper tax assessment and compliance. This topic explains the methods used to compute members' shares, the taxation process under various conditions, and practical examples to illustrate the assessment.

19.2 METHOD OF COMPUTING SHARE OF A MEMBER OF ASSOCIATION OF PERSONS, ETC. (Section 67A)

Section 67A seeks to provide for the method of computing a member's share in the income of an association ofpersons or a body of individuals, wherein the shares of the members are determinate, in the same manner as provided for in Sub-sections (1) to (3) of Section 67 for computing a partner's share in a firm. This section lays down the following methods of computing the member's share:

(a) Any interest, salary, bonus, commission or remuneration, by whatever name called, paid to any member in respect of the previous year shall be deducted from the total income of the association or body and the balance ascertained and apportioned among the members in the proportion in which they are entitled to share the income of the association or body.

(b) Where the amount apportioned to a member under (a) hereinabove is a profit, any interest, salary, bonus, commission or remuneration paid to the member by the AOP in respect of the previous year shall be added to that amount - the result shall constitute the member's share in the income of the association or body.

(c) Where the amount apportioned to a member under (a) is a loss, any interest, salary, bonus, commission or remuneration aforesaid paid to the member by the association or body in respect of the previous year shall be adjusted against that amount, the result shall be adjusted against that amount, and the result shall be treated as the member's share in the income of the association or body.

See also explanatory notes on the provision of DTL (Amendment) Act, 1987 Board circular No. 551 dated 23.1.1990 [(1990, 183 ITR 1 (SC)].

19.3 TAX ON INCOME OF ASSOCIATION OF PERSONS, ETC.WHICH IS INDETERMINATE OR UNKNOWN (NEW SECTION 167 B)

Section 167B seeks to provide that where the individual shares of the members of an association or body in the whole or any part of the income of such association or body are indeterminate or unknown, tax shall be charged on the total income of the association or body at the maximum marginal rate. However, where the total income of any member of such association or body is chargeable to tax at a rate which is higher than the maximum marginal rate, tax shall be charged on the total income of the association or body at such higher rate. Also, where the total income of any member of an association of persons or body of individuals as above for the previous year (excluding his share from such association or body) exceeds the maximum amount which is not chargeable to tax in the case of that member, tax shall be charged on the total income of the association or body at the maximum marginal rate. However, where any member or members of such association or body of individuals is or are chargeable to tax for the previous year at a rate or rates which is or are higher than the maximum marginal rate, tax shall be charged on that portion or portions of the total income of the association or body of individuals which is or are relatable to the share or shares of such member or members at such higher rate or rates, as the case may be, and the balance of the total income the association or body shall be taxed at the maximum marginal rate.

In the explanation to the above provisions, it is provided that the shares of the members of an association or body in the whole or any part of the income of such association or body shall be deemed to be indeterminate or unknown if such shares (in relation to the whole or any part of such income) are indeterminate or unknown on the date of formation of such association or body or any time thereafter.

CHECK THE PROGRESS

Multiple Choice Questions (MCQs)

1. What does Section 67A of the Income Tax Act deal with?
   a) Tax on companies
   b) Method of computing share of members in an AOP
   c) Tax rates for individuals
   d) Assessment procedure for trusts
   Answer: b) Method of computing share of members in an AOP
2. If the share of income of AOP members is unknown, at what rate is the AOP taxed?
   a) Minimum rate
   b) Average rate
   c) Maximum marginal rate
   d) No tax
   Answer: c) Maximum marginal rate
3. Which section excludes the member's share in AOP income from individual tax liability if the AOP is taxed at maximum marginal rate?
   a) Section 67A
   b) Section 167B
   c) Section 86
   d) Section 177
   Answer: c) Section 86
4. In an AOP, members share profits and losses according to:
   a) Government rules
   b) Profit and loss sharing ratio
   c) Random selection
   d) Tax department instructions
   Answer: b) Profit and loss sharing ratio

19.4 SHARE OF MEMBER OF ASSOCIATION (Section 86)

Section 86 relates to shares of members of an association of persons or a body of individuals in the income of the association or body. This section provides that if the assessee is a member of an association of persons or a body of individuals (other than a company or a Co-operative society or a Society registered under the Societies Registration Act, 1860, or any law corresponding to that Act in force in any part of India), his share in the income of the association or body, computed in the manner provided in Section 67A shall not be liable to tax. Further, where the association or body is chargeable to tax on its total income at the maximum marginal rate or any higher rate, under any of the provisions of the Income-tax Act, his share computed in the manner stated above shall not be included in his total income. But, in other cases and in cases where no income-tax is chargeable on the total income of the association or body, the member's share shall be chargeable to tax as part of his total income and Section 86 shall not be applicable to such case.

The charge of tax on the member's share in AOP will depend on the following factors:

(i) Income-tax is not payable by the member in respect of his share in the income of the AOP, computed in the manner provided in Section 67A.

(ii) His share in the income of the AOP is includible in his total income for rate purposes.

(iii) Where the AOP is chargeable to tax on its total income at the 'maximum marginal rate' or at any higher rate, the share of the member will not be includible in his total income. In this case, the member's share in the income of the AOP will not be included in his income even for rate purposes.

(iv) In any other case, the member's share will form part of his total income.

(v) Where no income-tax is chargeable on the total income of the AOP, the share of the member will be chargeable to tax part of his total income. Section 86 will not be applicable to such cases.

Assessment in case of Dissolution of an Association of Persons (Section 177) Where any business or profession carried on by an AOP has been discontinued or an AOP is dissolved, the Assessing Officer shall make an assessment of the total income of the AOP as if no such discontinuance or dissolution had taken place, and all provisions of this Act, including the provisions relating to the levy of penalty or any other sum chargeable under any provisions of the Income-tax Act shall apply.

Every person who was at the time of such discontinuance or dissolution a member of the AOP and the legal representative of any such person who is deceased, shall jointly and severally be liable for the amount of tax, penalty or other sum payable.

Where such discontinuance or dissolution takes place after any proceeding in respect of an assessment year have commenced, the proceedings may be continued against the members from the stage at which the proceedings stood at the time of such discontinuance or dissolution.

CHECK THE PROGRESS

True or False

1. The income of an AOP is always taxed at a flat rate regardless of the members' shares.
   False
2. Section 167B applies when members' shares in AOP income are indeterminate or unknown.
   True
3. Members of an AOP must pay tax on their share of income even if the AOP pays tax at the maximum marginal rate.
   False
4. Dissolution of an AOP does not affect the tax assessment of its total income.
   True

19.5 PRACTICAL PROBLEM

ILLUSTARATION I:

The total income of a AOP in which A, B & C are members share profits and losses in the ratio

of 1:2:2 was assessed at Rs. 16000. In computing the total income of Rs. 16000 the Income Tax Officer has made the necessary adjustments in respect of the following sums:
Salaries of Rs. 12000 and 8000 to A and B respectively.
Interest of Rs. 1000, Rs. 6000 and 25000to A, B and C respectively. Commission of Rs. 2000, 5000 and Rs. 7000 to A, B and C respectively.
C has borrowed capital for his investment in the firm and had paid interest of Rs. 15000 separately to the lender. Compute the share of the respective partners for their individual assessment.

Solution:

Allocation of Firms income amongst members

	A	B	C
Income			
Salary	12000	8000	Nil
Interest	1000	6000	25000
Commission	2000	5000	7000
Total	15000	19000	32000
Share of Income [16000-(15000+19000=32000)]	-10000	-20000	20000
Net share	+5000	+1000	+12000
Interest on loan taken by C			15000
Balance Share			3000

B and C cannot adjust their share of loss from their individual income. A's share shall be added in his individual income.

ILLUSTRATION II

Arun and Barun were members of an AOP whose accounting year ends on 31st March every year. On Ist April 2020 Shanti (Barun's wife) joined the firm as a member and there after all the three members are entitled to share profits and losses equally. Shanti invested a sum of Rs.

200000 as

her capital in the firm, the source of such investment being the gift received from her father. The other two members have no capital in the firm. Shanti is actively engaged in the business.

For the assessment year 2025-26, the firms total income has been determined by the income tax officer at Rs. 45000 after making due adjustments in respect of the following items:

1) Salary:		
Arun	*15000*	
Barun	*10000*	
Shanti	*10000*	*35000*
2) Interest on Capital		
Shanti		*28000*
3) Brokerage:		
Arun	*12000*	
Shanti	*12000*	*24000*

4) Rent

Barun (for the office premises owned by him) *9000*

Arun won a prize of Rs. 10000 in west Bengal State Lottery and a sum of Rs. 3000 was deducted at sourceout of the same. Shanti holds 10000 equity shares of a companyon which a dividend of 95 paise per share was declared by the company in its Annual General Meeting held on 28 March 2024.Apart from the above, no partner has any other income whatsoever.

SOLUTION:

Allocation of Firms income against partners

	Arun	Barun	Shanti
Income			
Salary	15000	10000	10000
Interest			28000
Brokerage	12000	Nil	12000
Total	27000	10000	50000
Share of Income			
[45000-(27000+10000+50000)]=42000 *Ratio equal-*	14000	-14000	- 14000
Net Share	+13000	-4000	+36000
Individual Income of members:			
House Property: For Barun[rent 9000 less 30%]	Nil	6300	Nil
Profits and gains: Share from AOP	13000	Nil	36000
Income from other sources:			
Lottery prize for Arun	10000	Nil	Nil
Dividend from Indian Co. for Shanti-exempted	Nil	NIL	NIL
Total income of each member	23000	6300	36000

Barun cannot set off his share of loss from AOP out of his individual Income

ILLUSTRATION III

Mr. K, Mrs. L and Mr. M are members of an AOP sharing profits and losses equally. During the year ending 31-2-2025 total income of AOP was 2,94,000. The details of individual income of its members are given below:

Mr. K

Rent from house property:	60,000
Interest on deposits with HUDCO	36,000
Bank interest	50,000
Short-term capital gain on sale of jewelry 40,000	
Mrs. L	
House property income (computed)	80,000
Bank interest on fixed deposits:	30,000
Interest on post office fixed deposit	12,000

Interest on debentures (gross)	96,000
Mr. M	
Pension from Govt.	1,96,000
Interest accrued on NSC VIII issue	12,600
Interest on Govt. securities	15,000

Compute tax liability of AOP and its members.

SOLUTION

Computation of tax liability of AOP

AOP shall pay tax at the rates applicable to an individual as total income of each (or all) of its members without adding share from AOP as calculated below does not exceed the exempted limit.

Tax on 29, 4,000	Rs.	Rs.
On 2,50,000 Nil		
Tax on balance Rs. 44,000@ 5%		2200
Add: Education Cess @ 4% of tax		88
Total tax payable		
		2288

Tax payable rounded off to Rs. 2290

Computation of total income and tax liability of members of AOP

Mr. K

Income from house property: ARV		60,000	
Less: Municipal tax		Nil	
Annual Value		60,000	
Standard Deduction 30%		18000	
		42000	
Income			
Capital gain: Short term capital gain on sale of jewellery			40,000
Income from other sources: Interest on deposits (HUDCO)		36,000	
Bank Interest	50,000	86,000	
Gross Total Income			1,68,000
Deduction u/s 80C to 80U:			Nil
Total Income		1,68,000	
Add: 1/3rd share from AOP: 1/3 of 2,94,000			98,000
	2,66,000		
Tax Liability:			
On 2,50,000:		Nil	
On 16,000@ 5%		800	
Tax		800	
Less: Rebate u/s 87A		800	
Tax Payable		Nil	

Mrs. L

House property income (computed)		80,000
Income from other sources: Bank Interest		30,000
Interest on post office deposits		12,000
Interest on debentures		96,000
Gross Total Income		
		2,18,000
Deduction u/s 80C to 80U	Nil	
Total Income		2,18,000
Add: 1/3rd share from AOP		98,000
		3,16,000
Tax Liability:		
On Rs. 250000	Nil	
On balance Rs. 66000 @ 5%	3300	
Tax	3300	
Less: Rebate u/s 87A	2000	
Tax		
	1300	
Add: Surcharge @ 4%	52	
	1352	
Less rebate u/s 86 at average rate	427	
[1352X100/316000=]		
Tax payable	925	

Tax payable rounded off Rs. 930

Mr. M

Income from salary: Govt Pension		1,96,000
Income from other sources: Interest accrued (NSC)	12600	
Interest (Govt. securities)	15000	27,600

Gross Total Income		
		2,23,600
Deduction u/s 80C: Interest acc. on NSC		12,600
Total Income		
		2,11,000
Add: 1/3rd share from AOP		98000
		3,09,000
Tax Liability:		
On 2,50,000	Nil	
On Balance Rs.59000 @ 5%	2950	
Tax		
	2950	
Less: Rebate u/s 87A	2000	
	950	
Add: Education cess @4%	38	
Total Tax		988
Less: rebate u/s 86A at average rate:		
[988 x 100/390000=0.32% of Rs. 98000]		239.5
Tax Payable		
		748.5

Tax payable rounded off 750

CHECK THE PROGRESS

Fill in the Blanks

1. Section ________ provides the method for computing the share of a member in the income of an AOP when shares are known.

   67A

2. When members’ shares in the income of an AOP are unknown, the AOP is taxed at the _______ marginal rate.
   maximum
3. Under Section _______, if an AOP is taxed at the maximum marginal rate, the member’s share of income is not included in his taxable income.
   86
4. The ratio in which members share profits and losses is called the _______ ratio.
   profit and loss sharing

19.6 LET US SUM UP

In this lesson, you learned that the income of an Association of Persons (AOP) is divided among its members according to their agreed shares. Section 67A explains how to calculate each member’s share when the shares are known, while Section 167B covers cases where shares are unknown or indeterminate, taxing the whole AOP at the highest rate. Section 86 states when a member’s share is included or excluded from their taxable income. The lesson also discussed how the AOP’s income is assessed if it dissolves and provided practical problems to understand the concepts better. Overall, this helps in correctly assessing and taxing the income of AOPs and their members under the Income Tax Act.

19.7 KEYWORDS

- **Association of Persons (AOP)**: A group of individuals or entities who come together for a common purpose and share profits or losses.
- **Member**: An individual or entity who is part of an AOP and entitled to a share of the income or loss.
- **Section 67A**: A provision in the Income Tax Act that explains how to compute each member’s share in the income of an AOP when the shares are determinate (known).
- **Section 167B**: A provision that deals with taxation when the shares of members in the AOP’s income are indeterminate or unknown. The AOP is taxed at the highest marginal rate.
- **Section 86**: This section specifies the conditions under which the member’s share of

income from an AOP is included or excluded from their individual taxable income.

- **Maximum Marginal Rate**: The highest rate of income tax applicable to an individual or entity's income.
- **Remuneration**: Any salary, bonus, commission, or payment given to a member of an AOP for their services.
- **Dissolution of AOP**: The process where the AOP ceases to exist or discontinues its business or profession.
- **Tax Assessment**: The official process of determining the amount of tax payable by an individual or association.
- **Profit and Loss Sharing Ratio**: The agreed proportion in which members of an AOP share the profits or losses

19.8 SELF ASSESSMENT QUESTIONS

1. Discuss tax liability of the members of Association of Persons.

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2. When does Section 167B apply to an AOP?

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3. How is a member's share of income from an AOP computed under Section 67A?

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19.9 LESSON END EXERCISE

1. What happens to tax liability when an AOP is dissolved?

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2. Explain the significance of Section 86 in the taxation of members of an AOP.

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3. State the circumstances, if any, under which their share of income from an association of persons is not chargeable to tax?

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19.10 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; Pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.

TAX PLANNING AND COMPLIANCE FOR FIRMS AND AOPs

STRUCTURE

20.0 LEARNING OBJECTIVES AND LEARNING OUTCOMES

Learning objectives

- Understand the fundamentals of tax planning and tax compliance for firms and Associations of Persons (AOPs).
- Identify the key tax planning strategies for firms and AOPs to minimize their tax liabilities while ensuring compliance with tax laws.
- Comprehend the audit requirements for firms and AOPs, including the provisions for tax audits and the implications of non-compliance.

- Examine the legal issues faced by firms and AOPs, including dispute resolution, penalties for non-compliance, and prosecution for offenses.
- Develop an understanding of tax benefits, deductions, and exemptions available to firms and AOPs under various sections of the Income Tax Act.

Learning outcomes

- Be able to apply tax planning strategies for firms and AOPs to minimize their tax liabilities effectively.
- Have a clear understanding of the legal framework for filing returns and meeting tax compliance obligations.
- Be able to prepare for a tax audit, including the relevant forms and documents required for filing.
- Understand the audit procedures and penalties associated with non-compliance.
- Be equipped to resolve disputes with tax authorities using legal mechanisms like appeals and tribunals.
- Recognize special tax treatment for charitable AOPs and understand the relevant compliance requirements for these entities.

20.1 INTRODUCTION

Tax planning and compliance are integral aspects of the business strategy for firms and Associations of Persons (AOPs). Both entities, while distinct in terms of their structural composition and purpose, are subject to the same broad provisions of the Income Tax Act, 1961, though with some nuances.

Firms, whether in the form of partnerships or limited liability partnerships (LLPs), can leverage tax planning strategies to reduce their taxable income through deductions, exemptions, and various allowable business expenses. For AOPs, the tax planning considerations are often more complex, especially when it involves multiple members with varying levels of participation and profit-sharing agreements.

This lesson delves into the key tax planning strategies, compliance obligations, and audit requirements that firms and AOPs must adhere to in order to ensure their operations remain within the bounds of the law while minimizing their tax liabilities. Special attention will also be given to the legal aspects that can affect their operations, including dispute resolution mechanisms and penalties for non-compliance.

20.2 TAX PLANNING FOR FIRMS AND AOPs

20.2.1 Tax Planning for Firms

Tax planning refers to the arrangement of financial affairs in such a way that tax liabilities are minimized without violating the provisions of the Income Tax Act. It is an essential process for firms to ensure that they comply with tax laws while paying the least amount of tax legally possible.

Key Areas of Tax Planning for Firms:

A. Registering a Firm under Section 184:

- Section 184 of the Income Tax Act requires firms to be registered to avail benefits like exemption of the partner's share of profits from tax. A registered firm enjoys the following benefits:
  - Exemption of Partner's Share of Profits: The share of profits received by the partners is not taxable in their hands (Section 10(2)).
  - Deductions: Partners can claim remuneration and interest on capital under Section 40(b), which is a deductible expense for the firm.
- Benefits: Reduced tax liability for partners and better recognition in the eyes of tax authorities.

B. Interest on Capital and Remuneration to Partners:

- Interest on Capital (Section 40(b)):
  - A firm can deduct interest paid on capital contributed by the partners, subject to a limit. The maximum rate of interest allowed is 12% per annum.
  - The firm must ensure that the interest paid to partners is reasonable and as per the agreement to avoid disallowance under Section 40(b).
- Remuneration to Partners (Section 40(b)):
  - A firm can also deduct remuneration paid to partners, subject to conditions. The remuneration is allowed within a specific limit, depending on the firm's profits.

    - The maximum allowable remuneration is based on the total income of the firm:
        - For first ₹3 lakh of profits: 90% of profits.
        - For the next ₹3 lakh: 60% of profits.
        - For profits exceeding ₹6 lakh: 40% of profits.

C. Tax Benefits under Section 80:

- Section 80 provides various deductions, such as:
    - Section 80C: Investment in tax-saving instruments like PPF, EPF, life insurance premiums, etc.
    - Section 80G: Deduction for donations to charitable institutions.
    - Section 80D: Deduction for premiums paid for health insurance.
    - Section 80E: Deduction for interest on education loans.

Firms can plan their investments to take full advantage of these deductions.

CHECK THE PROGRESS

One-Word Questions

1. Which form do firms and AOPs use to file tax returns?
    - **Answer:** ITR-5
2. What is the maximum penalty a firm can face for failing to comply with tax audit requirements under Section 271B?
    - **Answer:** ₹1,50,000
3. Which section of the Income Tax Act provides deductions for charitable donations?
    - **Answer:** Section 80G
4. What is the maximum interest rate allowed for capital contributions under Section 40(b)?
    - **Answer:** 12%
5. What is the maximum remuneration a partner in a firm can receive as a deductible expense under Section 40(b)?
    - **Answer:** Based on profit slabs (up to 90% for first ₹3 lakh)
6. What document must an AOP submit as part of its tax audit?
    - **Answer:** Form 3CD

20.2.2 Tax Planning for Associations of Persons (AOPs)

Tax planning for AOPs is a strategic approach that helps minimize the tax liabilities while ensuring compliance with the Income Tax Act, 1961. The structure of tax planning for AOPs is similar to that for firms, and includes optimizing exemptions, deductions, profit-sharing arrangements, and ensuring proper compliance.

1. Key Features and Structure of AOPs

- Definition: An AOP is a group of individuals or entities formed for the purpose of carrying out a joint venture or business. It is treated as a separate taxable entity under the Income Tax Act, 1961.
- Taxability: The income of an AOP is taxed under the same provisions applicable to individuals, which means it will be subject to individual tax slabs unless the AOP is a company.
- Profit Allocation: Income earned by an AOP is distributed among its members according to a profit-sharing agreement.

2. Tax Planning Strategies for AOPs

A. Utilize Exemptions and Deductions

1. Exemption under Section 10:
   - Agricultural income and income from certain charitable activities can be exempt under Section 10.
   - Income from trusts or religious activities may also qualify for exemption under Section 10(23C).
2. Deductions under Chapter VI-A:
   - Section 80C: Deduct investments in specific financial instruments (e.g., PPF, life insurance premiums).
   - Section 80D: Deduct premiums on health insurance policies.
   - Section 80G: Deduct donations to registered charitable organizations.
3. Interest on Capital Contributions:
   - AOPs can pay interest on capital to its members, which is deductible as a business expense, reducing the taxable income of the AOP.

4. Salaries and Remuneration:
    - Salaries or remuneration paid to members or employees can be deducted from the AOP's income, reducing overall tax liability, but the remuneration must be reasonable.

B. Structuring Profit-Sharing and Income Distribution

1. Profit Allocation Strategy:
    - Structure the profit-sharing agreement to allocate more profits to members in lower tax brackets. This reduces the overall tax burden for the AOP.
2. Reasonable Remuneration:
    - Pay reasonable remuneration to members for their involvement in the business. This is deductible for the AOP and taxable in the hands of the members, but it helps reduce the AOP's taxable income.
3. Capital Contributions and Interest:
    - Pay interest on capital contributions to members, which can be deducted from the AOP's income, reducing the overall tax liability.

C. Loss Utilization and Carry-forward of Losses

1. Business Losses:
    - If the AOP incurs business losses, they can be carried forward for 8 years and set off against future profits from the same business.
2. Capital Losses:
    - If the AOP incurs capital losses, these can be set off against future capital gains, optimizing tax liabilities in subsequent years.
3. Allocating Losses to Members:
    - Losses can be allocated to members to help them offset their own taxable income. This allocation must be done as per the profit-sharing agreement.

3. Compliance with Transfer Pricing and International Tax Rules

A. Transfer Pricing (For International AOPs)

- For AOPs involved in cross-border transactions, transfer pricing rules must be followed, ensuring that transactions between related parties are conducted at arm's length prices.
- The AOP must maintain detailed transfer pricing documentation to avoid adjustments by

the Income Tax Department.

B. Double Taxation Avoidance Agreement (DTAA)

- If the AOP has non-resident members, it can utilize the Double Taxation Avoidance Agreements (DTAA) between India and the respective countries to reduce withholding taxes on income distribution.

4. Structuring the AOP for Tax Efficiency

1. Optimize Legal Structure:
   - If the AOP is involved in a business like a partnership firm, consider converting it into a partnership under Section 184 or 185 for more favorable tax treatment.
2. Profit-Sharing Arrangements:
   - Review and optimize profit-sharing ratios between members based on their individual tax liabilities, especially if some members are in lower tax brackets.
3. Tax-efficient Investment:
   - If the AOP has substantial funds, investing in tax-efficient instruments can help reduce the overall taxable income.

5. Tax Planning for Charitable AOPs

If the AOP is established for charitable purposes, the tax planning will be slightly different:

1. Exemption under Section 11:
   - Charitable AOPs can claim exemption from income tax if their income is applied for charitable purposes as per Section 11 of the Income Tax Act.
2. Section 80G Deductions:
   - Donations made to charitable AOPs can be claimed for deductions under Section 80G, subject to conditions

20.3 TAX COMPLIANCE FOR FIRMS AND AOPs

Tax compliance refers to the adherence to the various legal obligations under the Income Tax Act, including filing returns, maintaining records, and timely payment of taxes.

A. Filing of Tax Returns for Firms and AOPs:

- Filing Forms:
  - Registered Firms: Firms that are registered under Section 184 must file their

returns using ITR 5.

  - AOPs: Associations of persons are also required to file returns using ITR 5.
  - Unregistered Firms: Even though unregistered firms do not enjoy the same benefits as registered firms, they are still required to file tax returns using ITR 5.

B. Due Dates for Filing Returns:

- Firms and AOPs generally need to file their returns before 31st July of the assessment year. However, this can be extended to 30th September if they are subject to tax audits.
- Firms that are subject to tax audits must file their return after the audit is complete.

C. Payment of Taxes:

- Advance Tax: Firms and AOPs are required to pay advance tax in four installments during the financial year if the total tax liability exceeds ₹10,000.
- Tax on Total Income: Firms must compute the tax on their total income and pay it in full before the due date of filing the return.

CHECK THE PROGRESS

True or False Questions

1. Firms can claim a deduction for interest paid on capital contributed by partners under Section 40(b).
   - **Answer: True**
2. An AOP's income is taxed under the same provisions as that of a company.
   - **Answer: False**
3. Section 10 of the Income Tax Act provides exemptions for agricultural income and certain charitable activities.
   - **Answer: True**
4. Firms and AOPs are required to file their tax returns using ITR-1.
   - **Answer: False**
5. If an AOP’s gross receipts exceed ₹1 crore, it is required to undergo a tax audit under Section 44AB.
   - **Answer: True**

20.4 AUDIT REQUIREMENTS OF FIRMS AND AOPs

20.4.1 Audit Requirements of firms

A. Tax Audit under Section 44AB:

- Firms whose gross turnover or receipts exceed ₹1 crore (or ₹50 lakh for professionals under Section 44AA) are required to get their accounts audited under Section 44AB.
- Audit Report: The firm must obtain an audit report in Form 3CA/3CB, along with a Form 3CD containing details about the firm's income and expenditure.
- Due Date: The tax audit report must be filed by 30th September.

B. Consequences of Not Getting Audited:

- If a firm does not get its accounts audited when required, it will face a penalty under Section 271B. The penalty is a fine of 0.5% of total sales, turnover, or gross receipts, subject to a maximum of ₹1,50,000.

C. Voluntary Audit:

- Even if not required by law, a firm may opt for a voluntary audit to ensure that their books of accounts are in order and minimize any future disputes with the tax authorities.

20.4.2 Audit Requirements of AOPs

1. Tax Audit Requirement Under Section 44AB

Section 44AB mandates a tax audit if the gross receipts or turnover of an AOP exceeds certain limits. The audit is conducted to ensure the accuracy of the financial records and compliance with tax laws.

When is an Audit Required?

An AOP must get its accounts audited if any of the following conditions are met:

1. For Business or Profession:
    - If the gross receipts or turnover of the AOP exceed ₹ 1 crore in a financial year, a tax audit under Section 44AB is mandatory.
2. For Non-Business Income (Other than Business or Profession):

    - If the total income of the AOP exceeds ₹ 2.5 lakhs before applying any deductions under Chapter VI-A (like deductions under Sections 80C, 80D, etc.), then the AOP is required to undergo an audit.

Tax Audit for AOPs:

- If the AOP's income exceeds the specified limit, the AOP is required to file a Tax Audit Report in Form 3CA or Form 3CB (depending on the AOP's nature of accounting).
- The audit is conducted by a Chartered Accountant (CA), who will provide a detailed report on the accuracy of the financial statements.

2. Due Date for Filing Audit Report

- The audit report must be filed before the due date for filing the Income Tax Return (ITR).
- Generally, the due date for filing the tax audit report is September 30 of the assessment year.
- However, this deadline may be extended by the Income Tax Department as per specific circumstances.

Late Filing Penalties:

- If the AOP fails to get its accounts audited by the due date, it may be subject to a penalty under Section 271B. The penalty is 0.5% of the total turnover or gross receipts of the AOP (whichever is less), subject to a maximum of ₹1,50,000.

3. Contents of the Tax Audit Report

The tax audit report should be submitted in Form 3CA/3CB (depending on the circumstances) along with the following documents:

- Form 3CD: This contains a detailed statement of all income, deductions, taxes paid, and other financial details. It includes items such as:
    - Profit and loss account
    - Balance sheet
    - Schedule of capital assets
    - Depreciation claims
    - Taxable income and exemptions under Section 10 (if applicable)
- The auditor's certificate in the form of an audit report which will include a certification stating that the accounts are true and fair and that the AOP has complied with the Income Tax provisions.

4. Books of Accounts to Be Maintained

The AOP is required to maintain books of accounts that reflect its financial transactions accurately.

The AOP must retain these records for at least 6 years from the end of the relevant assessment year, as per Section 44AA of the Income Tax Act.

5. Impact of Business/Professional Income on Audit Requirements

For an AOP engaged in business or professional activities, the tax audit requirements depend on the gross receipts or turnover:

1. If the gross receipts exceed ₹ 1 crore, the AOP must undergo a tax audit.
2. However, if the AOP's gross receipts are below ₹ 1 crore, there is no mandatory audit requirement unless the income exceeds ₹ 2.5 lakh.

6. Special Considerations for Charitable or Religious AOPs

If the AOP is a charitable organization (registered under Section 12A/12AA), the audit requirements may differ:

- If the AOP is involved in charitable activities and its annual income exceeds ₹ 1 crore, it will be required to undergo an audit under Section 44AB.
- In this case, the AOP is required to maintain records of donations, grants, and other income and submit a tax audit report along with its income tax return.

Charitable AOPs must also comply with the provisions under Section 80G, which deals with deductions available to donors.

7. Exemption from Tax Audit for Certain AOPs

There are cases where an AOP may not be required to undergo an audit:

- If the gross receipts do not exceed ₹ 1 crore (for business income) or ₹ 2.5 lakh (for non-business income), there is no mandatory tax audit.
- If the AOP qualifies for exemption under Section 10 (for specific types of income), it may not require a tax audit, subject to other criteria.

8. Audit of Non-Residents' AOPs

If the AOP has non-resident members, special attention is required when filing the tax audit report. The non-resident members may be subject to different tax treatment, especially under the provisions of the Double Taxation Avoidance Agreement (DTAA), if applicable.

For non-resident members:

- The tax audit report should include details about the non-resident status and the income distributed to the non-resident members.
- The income of non-resident members may be subject to Tax Deducted at Source (TDS) at a flat rate of 30%, and special care should be taken in determining this income share.

9. Consequences of Non-Compliance

If an AOP fails to comply with the tax audit requirements, it could face the following consequences:

1. Penalty under Section 271B: As mentioned earlier, a penalty of 0.5% of the total turnover or gross receipts (whichever is less) or ₹ 1,50,000 (whichever is lower) can be levied.
2. Scrutiny by Income Tax Authorities: Failure to comply with audit and filing requirements may invite scrutiny or audits by the Income Tax Department.
3. Ineligibility for Deductions: If the tax audit report is not filed in time, the AOP may not be eligible to claim certain deductions under the Income Tax Act, such as deductions under Chapter VI-A (e.g., Section 80C, 80D).

10. Audit of Charitable AOPs under Section 12A

Charitable AOPs must undergo an audit under Section 12A if their income exceeds the prescribed limit (₹1 crore). This audit is different from the standard tax audit and focuses on the compliance of the AOP with charitable provisions under the Income Tax Act.

20.5 LEGAL ISSUES IN FIRMS AND AOPs

A. Dispute Resolution Mechanisms:

- Firms and AOPs can face disputes with the Income Tax Department regarding income assessment, tax liability, etc.
- Appeals: If the firm or AOP is dissatisfied with the assessment order, they can file an appeal with the Commissioner of Income Tax (Appeals) under Section 246A.
- Tribunal: If the appeal before the Commissioner is not satisfactory, the firm can further appeal to the Income Tax Appellate Tribunal (ITAT) under Section 253.

B. Penalties for Non-Compliance:

- Penalty for Concealment of Income (Section 271(1)(c)): If the firm or AOP is found guilty of concealing income or providing inaccurate information, the penalty can range from 100% to 300% of the tax payable on the concealed income.

- Failure to File Returns (Section 271F): A penalty of ₹5,000 may be levied if the firm or AOP fails to file its return of income within the prescribed time.

C. Prosecution for Offenses:

- Prosecution under Section 276C: A firm or AOP can be prosecuted if they willfully attempt to evade taxes or fail to comply with tax regulations. This may lead to imprisonment and/or fines.

CHECK THE PROGRESS

MCQs (Multiple Choice Questions)

1. Which of the following is the primary purpose of tax planning for firms and AOPs?
    - a) Increase revenue for the government
    - b) Minimize tax liabilities while complying with the law
    - c) Avoid paying taxes altogether
    - d) Increase the overall profits of the firm
    - Answer: b) Minimize tax liabilities while complying with the law
2. Under which section of the Income Tax Act are firms required to register in order to avail benefits like exemption on partner’s share of profits?
    - a) Section 40(b)
    - b) Section 184
    - c) Section 80
    - d) Section 271B
    - Answer: b) Section 184
3. What is the maximum interest rate allowed for capital contributions under Section 40(b)?
    - a) 10% per annum
    - b) 12% per annum
    - c) 15% per annum
    - d) 18% per annum
    - Answer: b) 12% per annum
4. Which of the following is a tax deduction available under Section 80D?
    - a) Donations to charitable institutions

- b) Premiums paid for health insurance
- c) Interest on education loans
- d) Investment in public provident fund
- Answer: b) Premiums paid for health insurance

5. What is the due date for filing the tax audit report for firms and AOPs that are subject to tax audits?
    - a) 30th June
    - b) 31st July
    - c) 30th September
    - d) 31st December
    - Answer: c) 30th September
6. What happens if a firm fails to get its accounts audited when required?
    - a) No consequences
    - b) It will face a fine of up to ₹1,50,000
    - c) It will be eligible for tax exemptions
    - d) The tax authorities will ignore the failure
    - Answer: b) It will face a fine of up to ₹1,50,000

20.6 LET US SUM UP

In conclusion, tax planning and compliance for firms and AOPs are critical for ensuring that businesses not only meet their tax obligations but also take full advantage of the available tax-saving opportunities. By strategically planning their finances and ensuring adherence to the rules under the Income Tax Act, firms and AOPs can significantly reduce their tax liabilities while remaining compliant with the law.

Moreover, understanding the audit requirements and potential legal pitfalls ensures that businesses operate with transparency and avoid costly penalties or litigation. Legal issues such as disputes with tax authorities and non-compliance can jeopardize a firm’s or AOP's financial health, making it essential for them to seek expert advice and maintain proper records and documentation.

20.7 KEYWORDS

Tax Planning: The strategic process of organizing financial affairs in a manner that minimizes tax liability while complying with the provisions of the Income Tax Act. It involves selecting tax-efficient investments, structuring the business in a tax-friendly way, and claiming eligible exemptions and deductions.

Tax Compliance: The process of ensuring that a firm or AOP adheres to the tax laws of the jurisdiction in which it operates. This includes timely filing of tax returns, accurate reporting of income, and payment of taxes owed.

Firms: A business entity where two or more individuals or entities come together for a business purpose under a partnership agreement. It could include a partnership, limited liability partnership (LLP), or sole proprietorship.

AOP (Association of Persons): A group of individuals or entities that come together for a common business venture or purpose but are not incorporated as a company. AOPs are treated as taxable entities under the Income Tax Act.

Charitable AOP: An Association of Persons established for charitable purposes. These AOPs are subject to specific tax benefits and compliance requirements, such as tax exemptions under Section 12A and deductions for donors under Section 80G.

20.8 SELF ASSESSMENT QUESTIONS

1. What are the consequences of not complying with the tax audit requirements for an AOP?

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2. How can an AOP structure its profit-sharing arrangements to minimize tax liabilities?

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3. What is the due date for filing the tax audit report for firms and AOPs subject to a tax audit?

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20.9 LESSON END EXERCISE

1. What are the main conditions for deducting interest on capital and remuneration paid to partners in a firm?

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2. Explain how tax planning can help an AOP minimize its tax liabilities.

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3. What are the key benefits of registering a firm under Section 184 of the Income Tax Act?

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20.10 SUGGESTED READINGS

1. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

3. Dr. H.C Meharotra and Dr S. P Goyal: Income Tax Law and Accounts; Sahitya Bhavan Publications.

4. V. P Gaur & D. B Narang: Income Tax Law & Practice; Kalyani Publishers.

5. V. K Singhania & Kapil Singhania: Direct Taxes Law & Practices; Taxman Publications.

6. Mahesh Chandra, D. C Shukla, K. A Mahajan & M. A Shah: Income Tax Law & Practices; Pragati Publication, New Delhi.

7. Arvind Tuli & Dr. Neeru Chadda: Conceptual Clarity on Income Tax and Wealth Tax; Kalyani Publication, New Delhi.